

## NATIONAL INCOME

Definition: Is the total flow of income obtained by individual in an economy within a year.

OR

-Is the total value of all the expenditure by different people, government within an economy at a period of one year.

OR

-Is the value of final goods and service produced by a given country within a year.

### NATIONAL INCOME ACCOUNTING / MEASURES OF NATIONAL INCOME

National income measures are used to estimate the value of goods and services produced in an economy.

The following components are used in calculation of national income -:

#### Gross Domestic Product (GDP)

The most important concept of national income is Gross Domestic Product. Gross domestic product is the money value of all final goods and services produced within the domestic territory of a country during a year.

Algebraic expression under product method is,

$$\text{GDP} = \sum (P \times Q)$$

where,

GDP=Gross Domestic Product

P=Price of goods and service

Q=Quantity of goods and service

denotes the summation of all values.

#### Gross National Product (GNP)

Gross National Product is the total market value of all final goods and services produced annually in a country plus net factor income from abroad. Thus, GNP is the total measure of the flow of goods and services at market value resulting from current production during a year in a country including net factor income from abroad. The GNP can be expressed as the following equation:

$$\text{GNP} = \text{GDP} + \text{NFIA (Net Factor Income from Abroad)}$$

$$\text{or, GNP} = C + I + G + (X - M) + \text{NFIA}$$

Hence, GNP includes the following:

1. Consumer goods and services.
2. Gross private domestic investment in capital goods.
3. Government expenditure.
4. Net exports (exports-imports).
5. Net factor income from abroad.

### **Net National Product (NNP)**

Net National Product is the market value of all final goods and services after allowing for depreciation. It is also called National Income at market price. When charges for depreciation are deducted from the gross national product, we get it. Thus,

**NNP=GNP-Depreciation**

or,  $NNP = C + I + G + (X - M) + NAIF - \text{Depreciation}$

### **National Income (NI)**

National Income is also known as National Income at factor cost. National income at factor cost means the sum of all incomes earned by resources suppliers for their contribution of land, labor, capital and organizational ability which go into the years net production. Hence, the sum of the income received by factors of production in the form of rent, wages, interest and profit is called National Income. Symbolically,

**NI=NNP+Subsidies-Interest Taxes**

or,  $NI = NNP + \text{Subsidies} - \text{Interest Taxes}$

or,  $NI = C + G + I + (X - M) + NFIA - \text{Depreciation} - \text{Interest Taxes} + \text{Subsidies}$

### **Personal Income (PI)**

Personal Income is the total money income received by individuals and households of a country from all possible sources before direct taxes. Therefore, personal income can be expressed as follows:

**PI=NI-Corporate Income Taxes-Undistributed Corporate Profits-Social Security**

**Contribution+Transfer Payments**

**DISPOSABLE PERSONAL INCOME (DPI)**

$DPI = PI - \text{direct taxes} - \text{fines} - \text{fee} = \text{cost} + \text{saving}$

$$(i) \frac{y}{d} = c + 1$$

$$(ii) \frac{Y}{d} = c + s$$

Equate (i) and (ii)

$$C + I = C + S$$

$$I = S$$

Where I = Investment

S = saving

C = consumption

Qn 1: Given national income at market price is 100,000,000, indirect taxes 10,000,000 and subsidy 5,000,000. Calculate national income at factor cost

Soln:-

$$NI = NNP - \text{Indirect taxes} + \text{subsidy}$$

$$= 100,000,000 - 10,000,000 + 5,000,000$$

$$= 90,000,000 + 5,000,000$$

$$= 95,000,000/=$$

2: Given hypothetical economy of country x where GNP is 400,000,000, consumption of capital 4mil, Outflow of good and service 120mil, inflow of goods and service 180mil taxes 5mil, subsidies 30 mil. Calculate

$$\text{Net factor income from abroad} = \text{GNP} - \text{GDP}$$

## METHODS OF CALCULATING NATIONAL INCOME

### 1. OUTPUT APPROACH / PRODUCT METHOD.

This method adds all the sectors value of output in an economy or output approach measures the value of an economy at the source of production. It sums value of output from sector like mining, wildlife, and manufacturing e.t.c.

In output approach added by all firm in different stages of production can be added to get national income using output approach.

Example:

Suppose we have maize producer who sells maize to a miller at TSHS1500 per kilogram the miller changes the maize into flour and sells it to traders at TSHS 1000. Traders sell to the final consumer at TSH 2100/= to get the income using the value added method we add

Maize	1500
Value of flour	400
	200
	<hr/>
Value	2,100

## 2. EXPENDITURE APPROACH

This is a method where the value of spending on all final goods and service is added up to get the value of national income.

$$\text{Expenditure} = E = C + G + I + (X - M)$$

Where C – personal consumption expenditure

G-expenditure by the government

I-expenditure on investment

X-expenditure on export by buyers

M-expenditure on import

**Note:** (X – M)- Gives net export

$$\text{GDP} = C + I + G + (X - M)$$

$$\text{GNP} = \text{GDP} + \text{Net foreign income}$$

$$= C + I + G + (X - M) + \text{NFI}$$

## 3. INCOME APPROACH

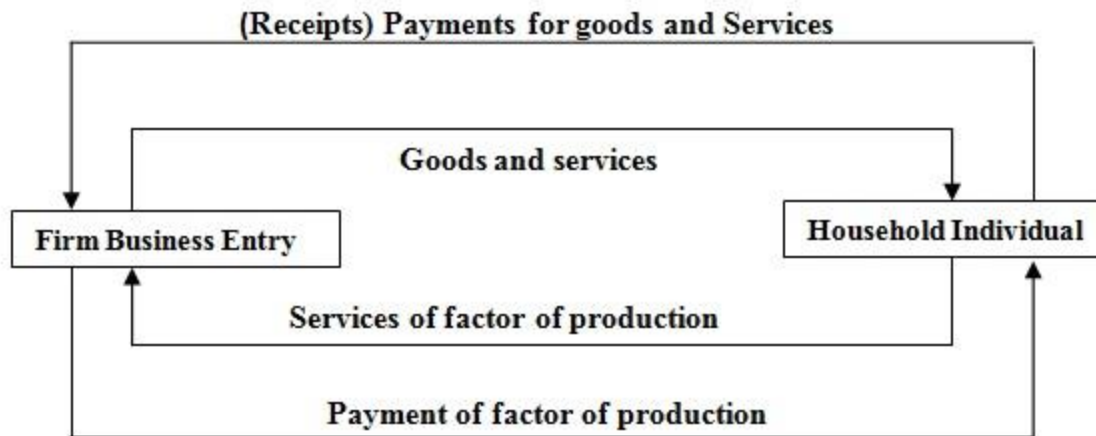
This method adds all incomes received by factor of production. They include wages, profit, interest, and rent.

$$\text{GDP} = \text{Wages} + \text{profit} + \text{rent} + \text{interest} + \text{operating surplus.}$$

## CIRCULAR FLOW OF NATIONAL INCOME

Qn: what is circular flow of national income?

Given: a simple closed economy with mainly two sectors i.e. household and firm (business) the flow of income can be illustrated as follows.



**In the above economy the following assumptions have been used**

1. It is a closed economy i.e there is no foreign trade
2. There are no leakages , every income received must be spent, e.g.; Saving-taxes-import
3. The economy has two sector namely household and firm
4. The household provide factors of production to firm and spend all the income it receives in purchase of goods and services.
5. It assumes there are no injections i.e there is no income arising from expenditure outside the economy.eg Investment-Government expenditure-Exports

Each time something is produced and sold its value is equal to the purchases expenditure .The purchaser expenditure will be received as income by those who produced. Hence  $E=O=Y$ . National expenditure is equivalent to national output equivalent to national income.

### **THE DETERMINANT OF THE SIZE OF NATIONAL INCOME**

1. Availability of resources and their utilization

These resources include natural resources, man-made and human resources; the more the resources utilized the more the income

2. Political and social stability
3. The availability of entrepreneur force in the economy
4. The size of capital accumulated by a country

The more the capital good the more the national income due to the investment

5. The level of technology

Advancement of technology leads to higher production leading to a higher national income

1. Government policy

This is particularly in developing policy such as infrastructure policy and privatization, licensing etc. The more the government policy is complicated the lesser the entrepreneur the lesser the output and hence the lower the national income.

## 2. The efficient of labor force

The more the labor is inefficient the lesser the quality and output affecting the size of National income.

## USES OF NATIONAL INCOME STATISTICS

1. National income statistics help to show the growth rate of an economy annually i.e. the government computes the national income and compares it with the other year and calculate the % of growth rate.
2. National income statistics helps to get per capital income.

Per capital income = National Income / Population

1. It is used to determine the effectiveness of the government in tax, revenue collection. The tax revenue collected should be proportional to the National income.
2. It helps to indicate resource utilization i.e. the more the National income the more the utilization of resources.
3. It is used for international comparison of economic growth and the performance of a country.
4. It is used for attracting foreign donors
5. It helps the government in making decisions on allocation of resource in different sector by accessing the contribution in national income. The best sector is considered in resource allocation.
6. Is used by the government in making policies e.g. Policies on employments e.t.c

## PROBLEMS ENCOUNTERED IN COMPILING NATIONAL INCOME STATISTICS.

1. Inaccurate data makes it difficult to get correct figure of national income and per capital income
2. Transfer payment, this are used in calculating personal income it is difficult to know their actual value e.g. The value of a gift
3. There is sometimes a problem of double counting .some items are included more than once in calculating national income e.g. Work in progress.
4. There is a shortage of qualified personnel in compiling data
5. Subsistence economy (non monetary activities)
6. Illegal activities i.e. black market, social evils
7. There is a problem of estimating income received from abroad.
8. Data from self employment activities is not easily available.

## KEYNESIAN APPROACH IN THE DETERMINATION OF NATIONAL INCOME EQUILIBRIUM.

According to Keynes national income equilibrium is determined at the intersection of demand and supply. In this argument he stated the following assumptions.

1. Keynes assumed that there are only two sector in an economy i.e. Household and firm.
2. The price of products are constant
3. He assumed that there is no government expenditure.

4. Keynes assumed that the supply of labor is constant.

Demand; according to Keynes is the total expenditure by the society, it is obtained from consumption and investment i.e. total demand is equal to total expenditure =  $C+I$

Hence  $Y = C + I$

Supply; is the total goods and services produced in a country within a year. According to Keynes supply = consumption + saving because when goods and services are sold the income received is spent on consumption and saving.

Hence total supply =  $C+S$

$$DD = SS$$

$$Y = C+I \quad Y = C + S$$

$$C + I = C+S$$

$$I = S$$

Hence; according to Keynes equilibrium in the national income is obtain when investment (I) is equal to saving (S)

#### **RELATIONSHIP BETWEEN CONSUMPTION AND INCOME.**

CONSUMPTION: Is the total expenditure by household which gives a satisfaction.

**CONSUMPTION FUNCTION:** Is a mathematical relationship between consumption and the level of disposable income. It is denoted by.

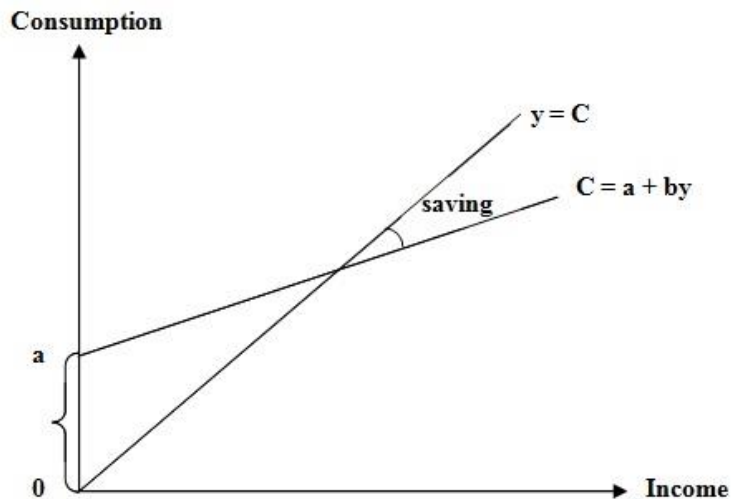
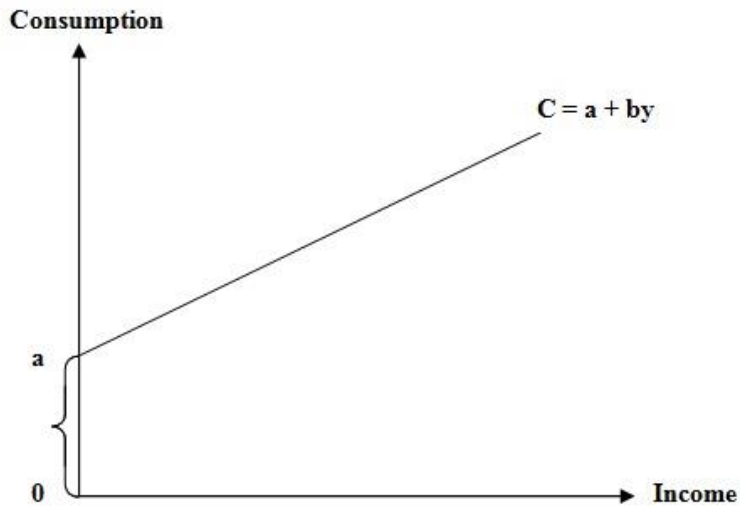
$$C = a + by$$

Where; c is consumption

a is autonomous consumption. This is consumption that does not depend on income. It comes from past saving and borrowing.

b is induced consumption i.e. consumption that depends on income i.e changes with change in income. This is the proportional of the income spent on consumption, it is also called marginal propensity to consume (MPC). it is a slope of consumption function

The consumption function can be illustrated graphically as follows.



Average propensity to consume (APC)

This is consumption per unit of income i.e it is total consumption divide by total income

$$APC = \frac{C}{Y} = \frac{(a+by)}{y}$$

Marginal propensity to consume (MPC)

Is the additional consumption resulting from additional income

$$APC = \frac{\Delta C}{\Delta Y}$$

**FACTORS AFFECTING/ DETERMINING THE LEVEL OF CONSUMPTION**

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1. The level of income (disposable income)
2. Government expenditure

The higher the government expenditure the higher the consumption

3. The more the taxes, the lesser amount spent for consumption.
4. Prices of goods and service.

The higher the prices of goods and services the lesser the level consumption.

5. A mount of undistributed profits.

The more the profit retain the less the income, the lower the consumption.

6. Changes in interest rate

Low interest rate on loans and savings increases consumption and high interest rate on loans and saving decreases consumption.

7. Population size.

Level of consumptions depends on level of population. When the population is higher the consumption is also higher and vice versa is true.

## RELATIONSHIP BETWEEN SAVING AND INCOME

Saving: refers to that part of income which is not spent in the current period.

**Saving function:** is a mathematical relationship between saving and income.

Qn. Derive the saving function.

$$Y = C + S \dots\dots\dots (i)$$

$$C = a + by \dots\dots (ii)$$

Substitute c in (i) in equation (ii)

$$Y = a + by + S$$

Make S the subject

$$S = y - a - by$$

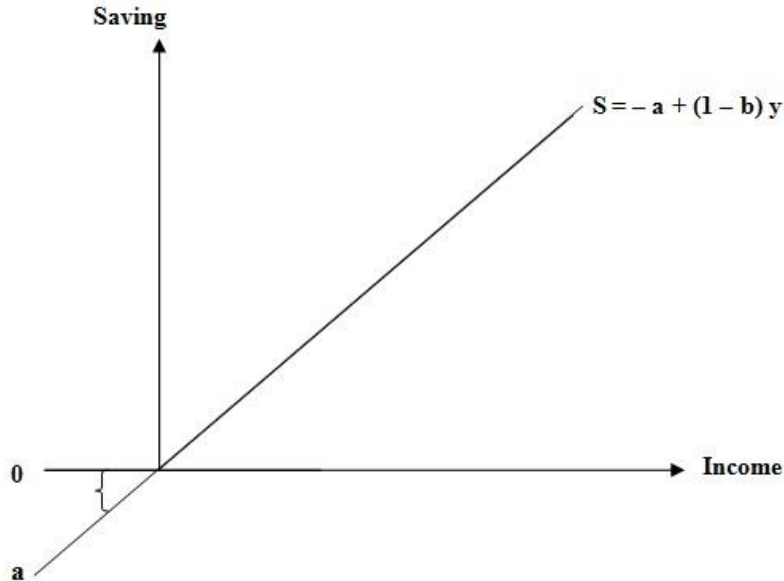
$$S = -a - by + y$$

$$= a + y - by$$

$$= a + y(1-b)$$

$$S = a + (1-b)y$$

The saving function can be illustrated as follows:-



### Average Propensity to Save (APS)

This refers to saving per unit income

$$APS = S/Y$$

### Marginal propensity to save (MPS)

Is additional saving resulting from additional income

$$MPS = \frac{\Delta S}{\Delta Y}$$

QN: show that  $MPS + MPC = 1$  where MPS is marginal propensity to save and MPC is marginal propensity to consume.

Soln;

$$Y = C + S$$

Assume there is a change in income bringing a both change in consumption and savings

$$Y = C + S$$

$$MPC = \frac{\Delta C}{\Delta Y} \quad \text{and} \quad MPS = \frac{\Delta S}{\Delta Y}$$

Divided throughout by change in income

$$Y/Y = C/Y + S/Y$$

$$1 = MPC + MPS$$

**QN. Why is  $MPS + MPC = 1$**

### FACTORS AFFECTING THE LEVEL OF SAVINGS

1. The level of income
2. Amount spent on consumption
3. Rate of interest on savings
4. Price of commodities
5. Government expenditure
6. The level of taxes
7. Government policy in establishing financial institution and educating people on savings.

### MULTIPLIER

- Is a change in equilibrium of net national products resulting from a change in investment
- Multiplier is the rate of change of national income resulting from changes in the determinant of the national income. It shows the number of times the investment has change to reach to a particular amount of national income.
- It is denoted by letter k. k multiplier is equal to change in income over change in investment.

Derivation of the Multiplier

Suppose the equilibrium income is given by  $Y = C + I$

$$Y_O = C_O + I_O \dots\dots\dots (i)$$

Assuming there is any change in investment leading to a new level of equilibrium

$$Y_1 = C_1 + I_1$$

To obtain a change in income subtract eqn (i) from (ii)

$$\Delta Y = \Delta C + \Delta I \dots\dots\dots (iii)$$

The change in I also being a change in C

The in consumption depends on MPC where

$$MPC = \Delta C / \Delta Y$$

$$\Delta C = MPC \times \Delta Y \dots\dots\dots$$

Substitute equal (IV) into (iii)

$$\Delta Y = \Delta Y - MPC \Delta Y + \Delta I$$

Make change in I subject

$$\hat{I} = \hat{Y} - MPC \hat{Y}$$

$$= \hat{Y} (1 - MPC)$$

Divided throughout by  $\hat{I}$

$$\hat{I}/\hat{I} = \hat{Y}/\hat{I} (1 - MPC)$$

$$1 = \hat{Y}/\hat{I} (1 - MPC)$$

Divide both sides by  $(1 - MPC) \times 1/(1 - MPC) = \hat{Y}/\hat{I}$

$$K = \hat{Y}/\hat{I} (1/(1 - MPC))$$

$$K = 1/(1 - MPC) \quad \text{OR} \quad K = 1/MPS$$

Qn1. Given that  $MPC = 0.2$  find the multiplier.

Soln:

$$K = 1/(1 - 0.2) = 1/0.8$$

$$= 1.25$$

Qn2. Given the  $MPC = 0.8$  find  $MPS$

$$MPC + MPS = 1$$

$$0.8 + MPS = 1$$

$$MPS = 1 - 0.8$$

$$MPS = 0.2.$$

Divide both sides by  $(1 - MPC) \times 1/(1 - MPC) = \hat{Y}/\hat{I}$

$$K = \hat{Y}/\hat{I} (1/(1 - MPC))$$

$$K = 1/(1 - MPC) \quad \text{OR} \quad K = 1/MPS$$

Qn1. Given that  $MPC = 0.2$  find the multiplier.

Soln:

$$K = 1/(1 - 0.2) = 1/0.8$$

$$= 1.25$$

Qn2. Given the  $MPC = 0.8$  find  $MPS$

$$MPC + MPS = 1$$

$$0.8 + MPS = 1$$

$$MPS = 1 - 0.8$$

$$MPS = 0.2.$$

Qn3: Given  $\hat{Y}$  to be 100 which result from a  $I$  of 20 find MPC.

$$K = \hat{Y} / \hat{I} = 100/20 = 5$$

$$K = 1/(1-MPC)$$

$$5/1 = 1/(1-MPC)$$

$$5(1 - MPC) = 1$$

$$5 - 5 MPC = 1$$

$$-5MPC = 1 - 5$$

$$-5MPC = -4$$

$$MPC = \frac{4}{5}$$

Q.N given (a) level of income.

$$Y = C + G + I (X - M)$$

$$= 150 + 0.8y + 50 + 30.05y + (20 - 0.1y)$$

$$= 250 + 0.75y$$

$$y - 0.75y = 250$$

$$0.25y / 0.25 = 250 / 0.25$$

$$Y = 1000$$

## INVESTMENT

### What is investment?

Is the expenditure that leads to an increase in the existing stock of capital goods.

The stock of capital should be aimed at yielding a more flow of goods and services in the future.

**Autonomic investment:** is an investment that does not depend on changes of income e.g.: investment in public goods and services.

**Induced investment:** is an investment that occurs as a result of changes in income.

### FACTORS AFFECT THE LEVEL OF INVESTMENTS.

1. Level of income
2. Marginal efficiencies of capital (MEC) i.e. rate of return on use of capital.
3. Availability of infrastructure.

4. The size of the market for goods and services produced (level of demand)
5. Cost of investments. When it is high or low affects the level of investments positively or negatively.
6. Government policy i.e. tax on import subsidies, privatization policy, and licensing procedure.
7. Rate of interest on borrowings

### Multiplier process

Is the process through which the initial change in income passes through the final stop where all of the income invested is saved i.e. savings is equal to amount invested.

Suppose an investment of 1000million is invested in road construction is made the investment will change into income when it is received. The money will be used in buying construction material and paying the workers and labors; they receive the money and will consume it and save part of that money. Suppose the MPC is 80% then,

Round of spending	Increase in Y consumption in Y	Cumulative income consumed	Savings	Cumulative saving
		1000		
		1800	200	200
			160	360

According the table above the receiver of the table will consume 800mil and save 200mil, the receiver of 800 will consume 80% which is 640 and save 160 the process will continue until saving is equal to investment.

The amount obtained at the end of the process can also be obtained using the multiplier formula thus.

$$K = \frac{\Delta Y}{\Delta I} = \frac{1}{1-MPC}$$

$$K = \frac{1}{1-0.8} = \frac{1}{0.2} = 5 \quad \Delta Y = \frac{\Delta I}{K} = \frac{1000}{5}$$

$$\Delta Y = 200$$

There are other forms of multiplier which includes tax, multiplier including.

$$1. \text{ Tax multiplier} = \frac{\Delta Y}{\Delta T}$$

$$\Delta T \text{ in taxes}$$

$$2. \text{ Govt expenditure multiplier} = \frac{\Delta Y}{\Delta G}$$

$$\Delta G \text{ in government exp}$$

$$3. \text{ Foreign trade multiplier} = \frac{\Delta Y}{\Delta X}$$

$\hat{Y}$  in net export

4. Income multiplier =  $\hat{Y}$

$\hat{Y}$  in total income

### Assumption of multiplier

1. The multiplier assumes that all income is spent on consumption.
2. It assumes MPC is constant
3. It assumes there is no scarcity of goods and services such that any & additional income must be spent in consumption,
4. It works in a closed economy where no effect of imported inflation.
5. It assumes that there are no leakages and injections.

### Limitations of multiplier process in LDC'S. Discuss

1. Lack of well established capital industries as a result of any investment established must involve the purchases of capital goods such as machines from developed country. The importation of capital goods from abroad causes a leakages (withdraw) to a multiplier, where it assumes there is no leakages. (outflow of income to abroad)
2. Lack of entrepreneur abilities in LDC'S thus for any investment must involve importation of experts from abroad which may cause leakages to the multiplier because it involves outflow of income.
3. Poor productivity due to low level of technology hence output produced in LDC'S is very low as a result LDC'S are forced to import goods and services from abroad which also causes leakages to the multiplier because it involves income outflow.
4. Poor infrastructure in LDC'S due to poor means of transport and communication it becomes cheaper sometimes to import goods and services from abroad than to buy it within a country resulting into leakages of multiplier process.
5. Low wages paid to the workers in LDC'S in order to meet their day to day transaction of buying goods and services hence they have to borrow money and when they received their income they use it to settle the debts. Hence affecting multiplier process.

### ACCELERATION PRINCIPLE

Show the relationship between changes in investment resulting from a change in income. It is brought about as follows, after multiplier process has taken place leading to an increase in income, this income will be invested by investors in different sectors until the amount is over for example:-

If a change in investment of 1000 bring a change in income of 5000 the multiplier process and the 5000 is then invested to bring a total investment at the end of 20,000 then the acceleration is 4.

Accelerator is denoted by letter V where V is equal to change in investment over change of income

$$V = \frac{\Delta I}{\Delta Y}$$

### INCOME INEQUALITY

Is the difference of income among different people

### Forms of income inequality

### **1. Individual income inequality**

Is difference in income among different individual result from different opportunities

### **2. Regional income Inequality**

The difference in regional depends on the availability of natural resources and their utilization.

### **3. Income in equality among sectors.**

Inequalities in a sector depend on the sector income e.g. TRA workers and teachers.

### **4. Rural – urban inequality**

## **CAUSES OF INDIVIDUAL INCOME INEQUALITY**

1. Education level
2. Inheritance
3. Social evils include corruption, smuggling, prostitution, black traffic etc.
4. Opportunities and luck
5. Ownership of major means of production
6. The tax system/ structure e.g. Regressive tax, high income in tax
7. Natural abilities i.e. talents.

## **ADVANTAGES OF INCOME INEQUALITY**

1. It brings about / good relationship and respect among people in the community
2. It encourages mobility of labor
3. It leads to creativity
4. It enables different, tax system to exist e.g. progressive tax system
5. It improves relationship between employee and employer.
6. It helps in promoting government policy like poverty eradication.

## **DISADVANTAGES OF INCOME INEQUALITY**

1. It creates/ led to political social problem/ instability.
2. It lead to social evils
3. It leads to exploitation of man by man.
4. It discourage investment to low income growing
5. It leads to rural – urban migration as result of rural – urban income difference.
6. It leads to decrease in consumption affecting demand
7. It leads to economic dualism i.e. Two groups of rich and the poor

## **MEASURES TO CONTROL INCOME INEQUALITY.**

1. By providing subsidies to low income group
2. By restricting the tax system hence using progressive tax system.
3. Providing equal opportunities to all such as free education
4. Control of major means of resources on ownership i.e. through nationalization policy.



5. Creating more employment opportunities
6. Government policies. The govt should indicate policies which will be geared to reduce/eradicating income inequality e.g. Family planning.

## METHODS OF SHOWING INCOME INEQUALITY.

### The Lorenz curve.

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**Meaning:** It is locus of points that shows cumulative percentage population and cumulative percentage income

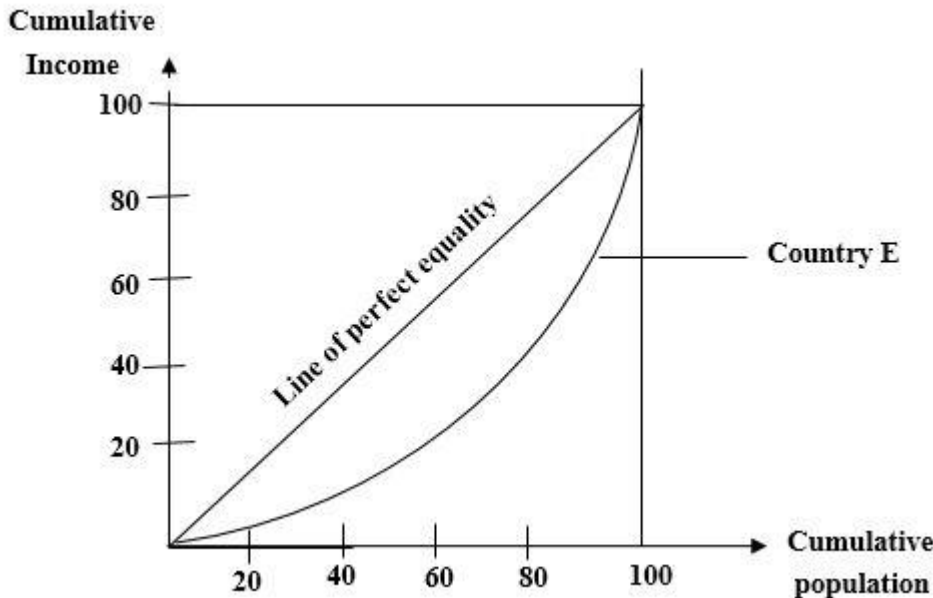
It is used to show how even/ uneven the income distribution is.

In interpreting the data from Lorenz curve, the following are important.

1. The further the curve from the line of perfect equality the poorer distribution of income.
2. The closer the curve from the line of perfect equality the better income distribution.(The more the equality the income is distributed)
3. In drawing a Lorenz curve the data is grouped into groups of fifths or %
4. Cumulative data is used in drawing

Population	Income%	Cumulative population%	Cumulative income %
1 <sup>st</sup> fifth	4	20	4
2 <sup>nd</sup> fifth	7	40	11
3 <sup>rd</sup> fifth	12	60	23
4 <sup>th</sup> fifth	30	80	53
5 <sup>th</sup> fifth	47	100	100

## LORENZ CURVE



### Interpretation

- The 5<sup>th</sup> fifth or upper fifth own 11 times of wealth/ income more than the lower fifth i.e.  $47/4 = 11.75$
- The upper fifth own 6 times more the 2<sup>nd</sup> fifth i.e.  $47/7 = 6.7$
- The upper fifth own 1 times more than the 4<sup>th</sup> fifth i.e.  $47/30 = 1.6$

## THE CONCEPT OF FULL EMPLOYMENT, INFLATIONARY GAP AND DEFLATIONARY GAP

### FULL EMPLOYMENT

Is a situation where all persons who are willing and able to work are employed, during full employment the resources are fully utilized and national income is at maximum.

### INFLATIONARY GAP

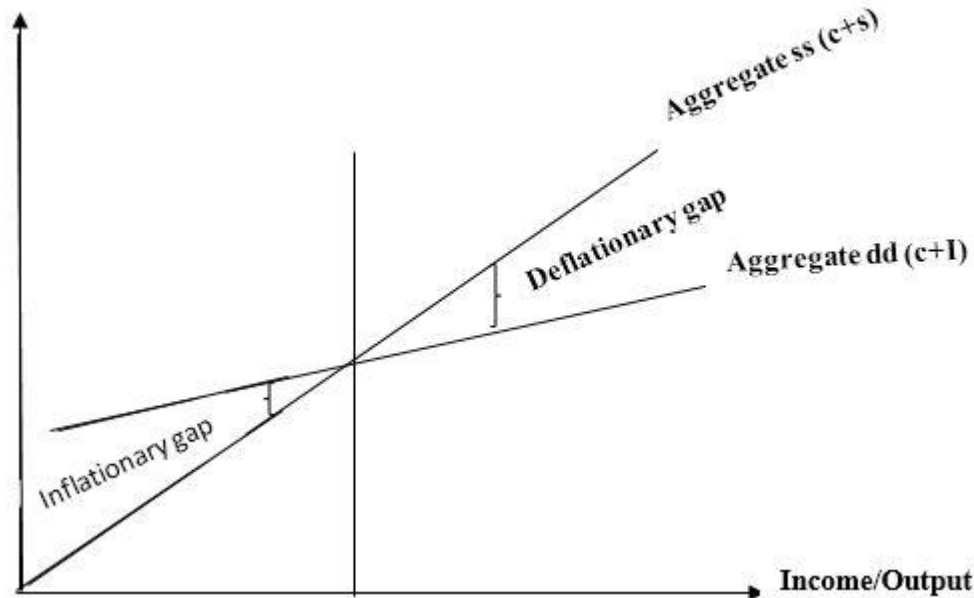
This is a situation where aggregate supply (consumption + saving)

=  $C + S$  is lesser than aggregate demand (consumption + investment) i.e.  $C + S < C + I$  hence  $S < I$

### DEFLATIONARY GAP

This is a situation where aggregate expenditure is lesser than aggregate supply. The gap shows the amount at which the expenditure should be increased to attain full employment.

Expenditure  $Y = (C+I)$



## PER CAPITAL INCOME

QN1. What is **per capital income**?

Is the income of an individual out of the national income.

$$\text{PER CAPITAL INCOME} = (\text{NATIONAL INCOME}) / (\text{TOTAL POPULATION})$$

Per capital income is not a good indicator of standard of living (welfare) of the people in a given country due to the following reasons: Per capital income doesn't put into consideration the distribution of income among the people. It assumes that all people earn the same income i.e. employed & none employed.

1. The size of per capital income depends on size of National income.

National income value includes all expenditure even those which does not reflect to welfare like buying weapons e.t.c which does improve standard of living.

2. The value of National income depends on the price of commodities. Higher prices leads to higher national income, higher capital hence low standard of living.

3. Per capital income depends on the size of population. The Lower the population the higher per capital income this might not be truth for better living standard.

4. National income and per capital income might be higher because of incorrect data.

5. The National income does not take into account the social cost in the process of production such as pollution, health hazards e.t.c which also affects the welfare of people.

6. Different countries have different exchange rate making it difficult to compare per capital income and standard of living.

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## **PUBLIC FINANCE.**

- Is the study of how the government or public sector pays for or finance expenditures through taxes and borrowing .Public finance adapts and applies the fundamental microeconomic theory of markets to the public sectors and government sectors.In particular,this area of study analyses the efficiency of taxes and the market failure of public goods.Public finance is also a key to the study of government stabilization policies that address the inflation and unemployment problems of business cycle.

### **THE FOLLOWING ARE THE FUNCTIONS OF THE GOVERNMENT.**

1. The government makes sure it maintains peace and harmony by providing security among their people. The government does it through employing policemen, armed forces, magistrate etc.
2. Administrative function,

The government is responsible for the day to day running of activities in the economy, i.e. the government sets different departments and sectors to enable it administer their activities in its economy.

3. Social function.

The government provides social needs such as education, health, housing etc.

4. Development function.

The government provides funds for projects like roads construction, rural electrification, irrigation etc.

### **DIVISION OF PUBLIC FINANCE.**

Public finance is divided into four areas including

1. **Public revenue**
2. **Public expenditure**
3. **Government budget**
4. **Public borrowing / debt**

### **GOVERNMENT REVENUE.**

Refers to the amount of money which received by the government from different sources.

The following are source of government revenue;

**i) Tax:** is a compulsory payment levied by the government on individuals or companies to meet the expenditure which is required for public welfare.

**ii) Fees:** Are all payment made to the government on any direct services rendered/provided. E.g. payment of road licenses, stamp duty.

**iii) Fines:** Are penalties imposed by the government to the law breakers.

**iv) State property:**(Also known as public property)is a property that is owned by all, but is accessed and use is controlled by the state.An example is a National Park or National Stadium.

**v) Selling of public good:** Like government shares,Through privatization of public companies like Tanesco in 2005,National Micro-finance Bank (NMB) in Tanzania hence the amount of money earned is revenue.

**vi) Profit obtains from government properties like bus stations and public buses like UDA,uses of roads and airports etc.**

**vii) Special assessment:** It is amount of money charged to people living in an area for specific purpose.

**viii) Internal loan from central Bank for different uses like government projects.**

**ix) External loan from International financial Institution WORLD BANK, IMF and Development bank.**

**x) Grant and gifts inform of cash.**

**xi) Foreign Investment**

**xii) Gambling.**

### **TAXATION.**

is the imposition or infliction of taxes.The process whereby charges are imposed on individuals/property by legislative branch of the state or federal government to raise funds for public purposes.

The following principles or cannons are important for good tax system when tax is imposed it must fulfill the following conditions.

### **CANONS OF TAXATION (PRINCIPLE)**

According to Adam smith there are four important canons of taxation which are( canons of equity,certainty,convenience and economy)and other additions like canon of

**productivity,elasticity,flexibility,simplicity and diversity as discussed below.**

### **1. Canon of Equity.**

he principle aims at providing economic and social justice to the people. According to this principle, every person should pay to the government depending upon his ability to pay. The rich class people should pay higher taxes to the government, because without the protection of the government authorities (Police, Defence, etc.) they could not have earned and enjoyed their income. Adam Smith argued that the taxes should be proportional to income, i.e., citizens should pay the taxes in proportion to the revenue which they respectively enjoy under the protection of the state.

### **2. Canon of Certainty**

According to Adam Smith, the tax which an individual has to pay should be certain, not arbitrary. The tax payer should know in advance how much tax he has to pay, at what time he has to pay the tax, and in what form the tax is to be paid to the government. In other words, every tax should satisfy the canon of certainty. At the same time a good tax system also ensures that the government is also certain about the amount that will be collected by way of tax.

### **3. Canon of Convenience**

The mode and timing of tax payment should be as far as possible, convenient to the tax payers. For example, land revenue is collected at time of harvest income tax is deducted at source. Convenient tax system will encourage people to pay tax and will increase tax revenue.

### **4. Canon of Economy**

This principle states that there should be economy in tax administration. The cost of tax collection should be lower than the amount of tax collected. It may not serve any purpose, if the taxes imposed are widespread but are difficult to administer. Therefore, it would make no sense to impose certain taxes, if it is difficult to administer.

### **Additional Canons of Taxation**

Activities and functions of the government have increased significantly since Adam Smith's time. Government are expected to maintain economic stability, full employment, reduce income inequality & promote growth and development. Tax system should be such that it meets the

requirements of growing state activities.

Accordingly, modern economists gave following additional canons of taxation.

### **5. Canon of Productivity**

It is also known as the canon of fiscal adequacy. According to this principle, the tax system should be able to yield enough revenue for the treasury and the government should have no need to resort to deficit financing. This is a good principle to follow in a developing economy.

### **6. Canon of Elasticity**

According to this canon, every tax imposed by the government should be elastic in nature. In other words, the income from tax should be capable of increasing or decreasing according to the requirement of the country. For example, if the government needs more income at time of crisis, the tax should be capable of yielding more income through increase in its rate.

### **7. Canon of Flexibility**

It should be easily possible for the authorities to revise the tax structure both with respect to its coverage and rates, to suit the changing requirements of the economy. With changing time and conditions the tax system needs to be changed without much difficulty. The tax system must be flexible and not rigid.

### **8. Canon of Simplicity**

The tax system should not be complicated. That makes it difficult to understand and administer and results in problems of interpretation and disputes. In India, the efforts of the government in recent years have been to make the system simple.

### **9. Canon of Diversity**

This principle states that the government should collect taxes from different sources rather than concentrating on a single source of tax. It is not advisable for the government to depend upon a single source of tax, it may result in inequity to the certain section of the society; uncertainty for the government to raise funds. If the tax revenue comes from diversified source, then any

reduction in tax revenue on account of any one cause is bound to be small.

## 1. SYSTEMS OF TAXATION.

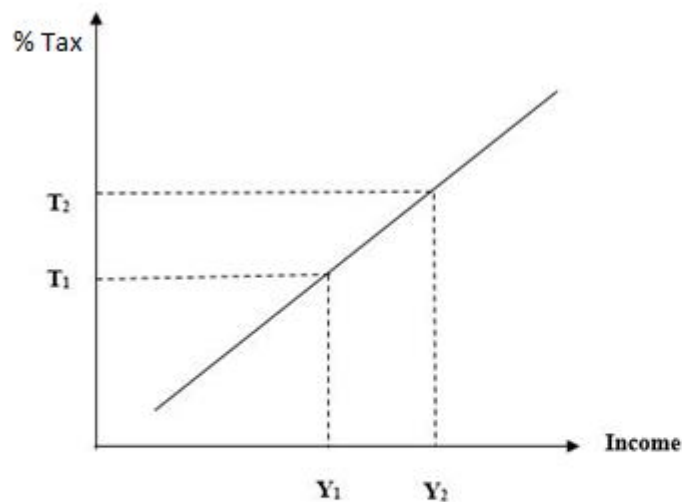
There are mainly three tax systems.

### 1. Progressive tax systems.

This is a tax system in which the tax rate increase with increase in income. It is aimed at reducing the gap between the rich and the poor (income gap) or income inequality.

Example of progressive tax is direct tax from income which is PAYE (Pay As You Earn).

It can be illustrated as follows.



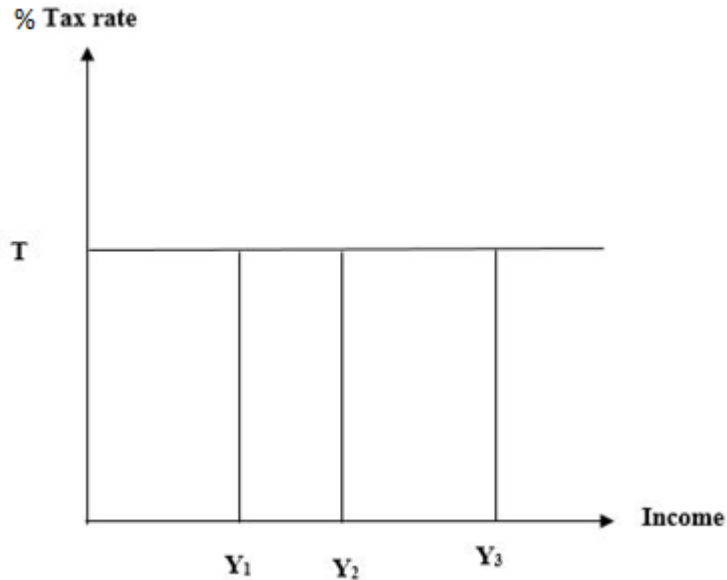
### 2. Proportional tax system. eg changes in income.

This is a tax system in which the tax rate is constant or fixed regardless of the changes in income. Aim to collect more money. Proportional taxes maintain equal tax incidence



regardless of the ability-to-pay and do not shift the incidence disproportionately to those with a higher or low economic well-being

Graphical illustration.

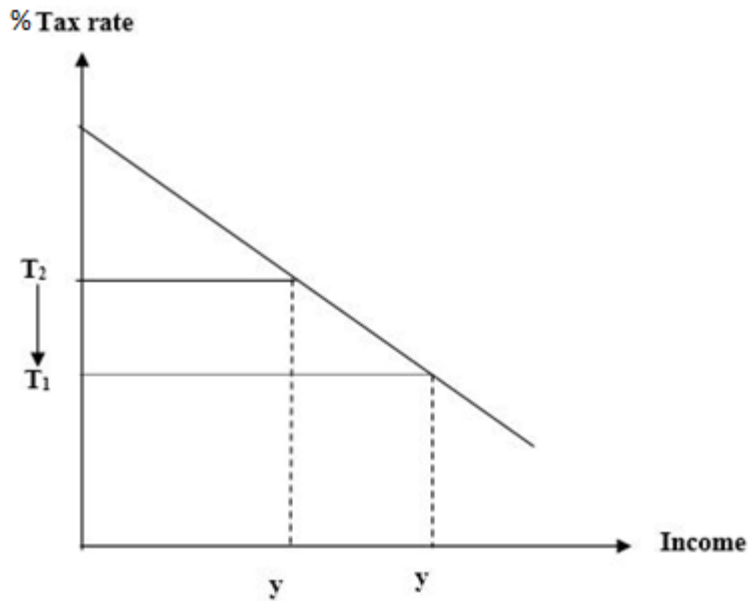


### 3. Regressive tax system.

A tax system where the tax rate decreases with increase in income (The higher the income, the lower the proportional of the income is paid as tax and the lower the income, the higher the proportional of the income is paid as tax. It is mainly used to encourage investments. Example Social security tax, for 2007 in USA, you pay 6.2% tax on wages up to a maximum wage of \$97,500. Therefore

- (i) A person who makes \$30,000 a year pays \$1,860 ( $30,000 \times 0.062$ ) in tax or 6.2% of wages
- (ii) A person who makes \$200,000 a year pays \$6,045 ( $97,500 \times 0.062$ ) in tax or 3% of wages.
- (iii) A person who makes \$500,000 a year pays \$6,045 ( $97,500 \times 0.062$ ) in tax or 1.2% of wages.

Since the richest people pay the smallest percentage of their income in tax, it is a regressive tax.



### Requirement of a Good Tax Structure / System

The tax structure is a part of economic organization of a society and therefore fit in its overall economic environment. No tax system that does not satisfy these basic condition can be termed a good one.

However, the state should pursue mainly following principles in structuring its tax system :-

- 1.The primary aim of the tax should be to raise revenue for public services.
- 2.People should be asked to pay taxes according to their ability to pay and assessment of their taxable capacity should be made primarily on the basis of income and property.
- 3.Tax should not be discriminatory in any aspect between individuals and also between various groups.
- 4.Tax system should be flexible and tax law should be clear and simple.
- 5.They should be comprehensive,it covers a wide tax base
- 6.They should be economical,should reduce the cost of tax administration
- 7.It should avoid double taxation.

### TYPES OF TAX

#### 1: DIRECT TAX.

Taxes which are imposed on incomes and personal property and whose burden is not shifted to another.

The direct tax includes (a) Pay as you earn(PAYE) (b) corporation tax (c) Capital gain tax (d) Agriculture revenue tax (e) Death/estate duty. (f) Property tax (g) Inheritance duty (h) Surtax. is the tax imposed on very rich person who earn much money.

## **ADVANTAGES OF DIRECT TAX.**

1. It is economical i.e. cost of collection is minimum.
2. It is a source of revenue to the government
3. Tax payers know in advance the amount to be paid as tax
4. Most of direct taxes are progressive hence do not affect much the poor and hence reducing income gap.
5. Direct taxes are simple to understand
6. Helps to reduce demand pull inflation by reducing purchasing power of consumer.
7. Easy to determine the incidence of taxation.

## **DISADVANTAGES OF DIRECT TAX.**

1. Discourage savings
2. Discourage people to work hard
3. Easy to evade
4. Discourage consumption as a result of decrease of disposable income
5. It discourages investment when charged on profit
6. It is not paid by all people i.e. unemployed are not paying
7. The burden of tax is highly felt

## **2. INDIRECT TAX.**

Are taxes usually imposed on commodities. This tax can be passed from one person to another in terms of high prices.

This includes

1. Excise duty,- charged on local produced goods
2. Sales tax on locally produced goods on selling
3. Custom duty this includes import and export duty
4. Value added tax.

## **ADVANTAGES OF INDIRECT TAX.**

1. Not easy to evade.
2. They results into higher level of revenue
3. It is convenient to pay by tax payers.
4. The effect of the tax is felt by consumers.
5. They are used to control the consumption of harmful products.
6. They are used to protect domestic industries.
7. They are used to stabilize the economy through increase and decrease of custom duty.
8. They encourage people to work hard i.e. the higher the price of commodities the harder people will work.
9. They are useful in control of allocation of resources.

## DISADVANTAGES OF INDIRECT TAX.

1. Indirect tax are regressive or proportional ie the poor and rich pay the same amount hence affecting the poor.
2. It leads to cost push inflation.
3. They encourage black market, this occurs when indirect taxes are highly imposed.
4. Indirect taxes are not easily to determine who bares the incidence of the tax.
5. Discourages industrialization when tax imposed on goods produced hence high cost of production.
6. Indirect tax save time and lead to misallocation of resources since investors may invest in low tax areas.
7. It leads to inconvenience to businessmen because it requires a follow up.

**Qn :** Why do most LDCs depend on indirect tax more than direct tax. Disadvantages of direct and advantages of indirect tax.

## VALUE ADDED TAX (VAT)

- Is the tax imposed on the value added on commodities at different stages of production.
  - It is the tax valued at each stage of production.
1. VAT is only paid and accounted from registered VAT tax payers.
  2. VAT is remitted by the tax payers within a period of one month from the day of purpose.
  3. VAT is imposed on sales at every stage of production each cost is final consumer inform of high prices.

VAT is a tax on expenditure, it is a tax goods and services at each of production.

## ADVANTAGES OF VAT.

1. It widens the tax base, it reaches many consumers.
2. It easy to calculate when records are available.
3. It is non discriminative to factors of production, since their taxed equally.
4. It encourages traders to keep books of accounts.
5. It shifts the incidence right away to the consumer ( it is easy to know the final payer of tax).
6. It enables tax payer to use government revenue before remitting the amount of tax offices.
7. It enables some goods to enjoy tax exemption.
8. It minimizes tax evasion since traders would pay for demand or receipts.

## DISADVANTAGES OF VAT.

1. The tax is proportional hence affect the small firms.
2. It leads to increase in prices.
3. It is not economical.

4. It is not easy to understood by tax payers (consumers).
5. It delays government revenue since tax payers remit the amount after a given time.
6. It affects the level of consumption in the country due to high price.

## **IMPORTANT TERMS IN TAXATION.**

### **1. TAX EVASION.**

Is a situation where tax payer refuses to pay the tax assessed to her/him by tax officers. It is illegal.

### **2. TAX AVOIDANCE.**

Is a situation where a tax payer falls to pay tax using the loophole in the tax law. It is not illegal.

### **3. . SPECIFIC TAX**

This is a tax of a fixed amount per unit purchased.

### **4. AD VALOREM TAX**

This refers to a tax which is based on the value of the goods it is percentage tax for example, sales tax, property tax etc.

### **5. THE BURDEN OF A TAX.**

Refers to the feeling of tax payer as he/she pays the tax.

### **6. TAX BENEFIT PRINCIPLE.**

It state that ‘the amount of tax paid by tax payer should be related directly to the benefit the tax pay will get after the government has spent its revenue.

### **7. ABILITY TO PAY PRINCIPLE**

It state that, ‘the tax imposed on tax payers should be according to their taxable capacity i.e. high income earners higher taxes and lower income earns lower taxes.

## **INCIDENCE OF TAXATION.**

Refers to the burden to pay tax, the final payer of the tax i.e. when a tax is paid who actually pays the tax.

The incidence of tax can either be formal incidence (among burden) or effective incidence (final resulting of the tax)

The incidence of tax can be seen in the following cases case of direct.

1. **Case of direct tax.**

In case of direct tax the incidence rest on the person who pays the tax first. It can be shifted to someone else.

2. **Case of indirect tax.**

In indirect tax the incidence can be shifted into two ways

There are

1. **Forward shift:** is a situation where the tax burden is shifted to final consumer inform of high prices.
2. **Background shift:** as tax is imposed the seller, negotiate with the producer to lower the price.

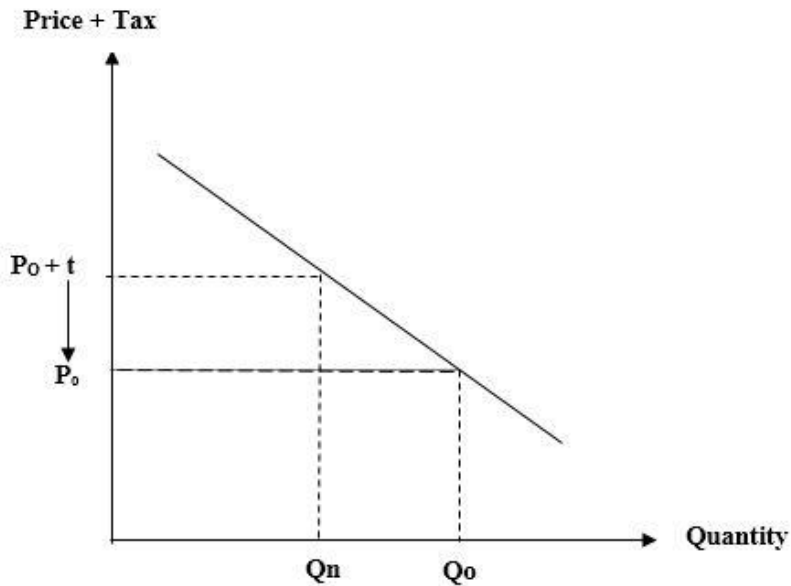
The incidence of a tax under indirect tax can be shifted either to the supplier or buyer (consumer). This shifting will depend on elasticity of demand for the commodities concerned, this can be good shown as follows:-

1. **When the demand is elastic.**

Elastic demand refers to the elasticity where a small change in price (increase or decrease) leads to big change in quantity (increase or decrease.)

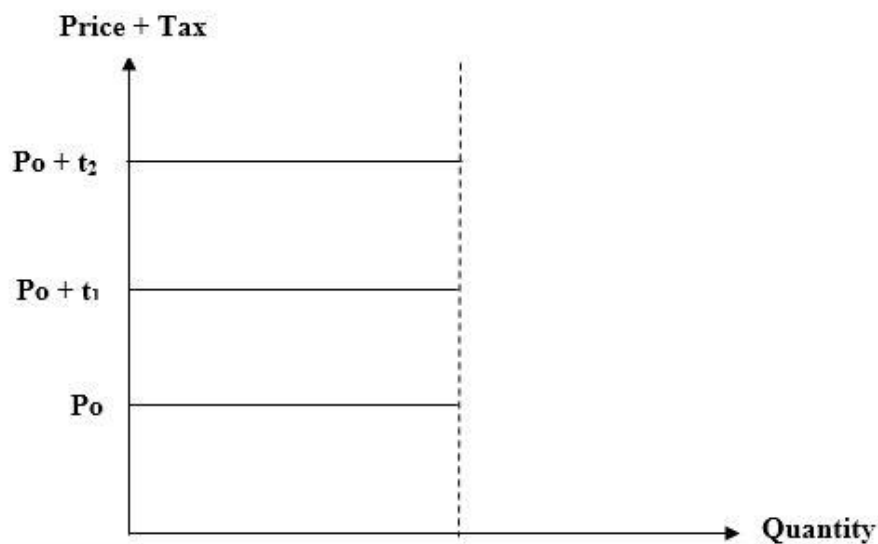
When commodities have elastic demand the burden of tax is born by the seller and cannot be shifted to the buyer. An increase in tax means an increase in price leading to a big increase in quantity demanded.

Illustration;



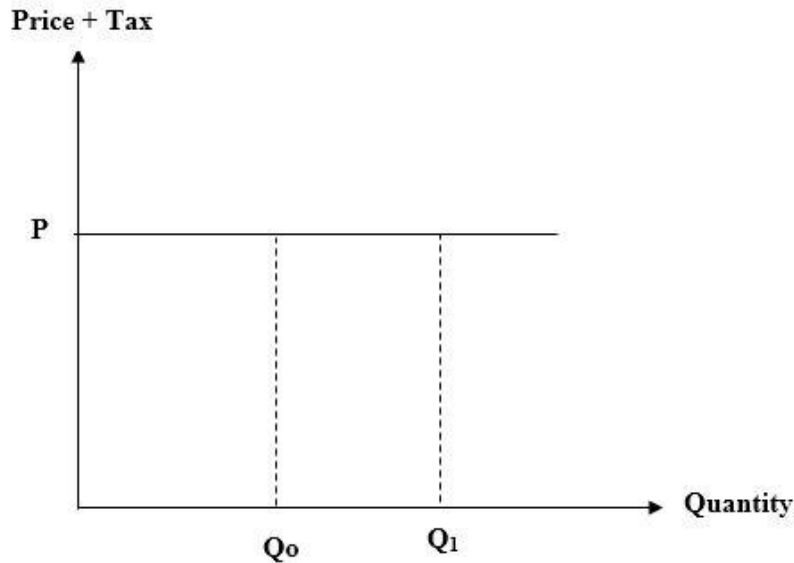
### 1. When the demand is perfectly inelastic.

Perfectly inelastic demand refers to the elasticity in which price changes do not change the quantity demanded. This is the demand of necessary goods which do not have substitute. In case of such goods an introduction of tax would lead to an increase in price and the burden of the tax is shifted to the buyer.



### 1. When the demand is perfectly elastic.

Perfectly elastic refers to elasticity in which the price remains constant with changes in quantity. The whole burden of the tax is paid by the supplier.



## 2. When the demand is inelastic

The elasticity of demand of commodity is said to be inelastic when a big change in price leads to a small change in quantity demand. In this case the burden of tax falls to the buyer (consumer)

## THERE ARE FACTORS THAT MAY DETERMINE THE SHIFTING OF THE INCIDENCE.

### 1. The market power of the buyers and sellers.

For a case of monopoly the whole burden is shifted to the buyer through price discrimination while under perfect competition it taken by supplier.

### 2. The tax base

If the tax base is narrow its difficult to shift the tax burden i.e. if few commodities are taxed and a tax is introduced on other commodities the tax payer would substitute those tax commodities with untaxed commodities and vice versa.

## WHY PAYING TAX. (Positive effect of tax)

1. To increase government revenue
2. To control harmful goods
3. To reduce the gap between the rich and the poor



4. To enable the government to provide public services
5. To control importation of goods and hence correct the balance of payments
6. To protect domestic and infant industries
7. To control allocation of resources
8. Stabilizing the economy.

### **NEGATIVE EFFECTS OF TAXATION.**

1. It discourages savings
2. It discourages hard working
3. It discourages investment
4. It can lead to illegal activities
5. It may cause inflation
6. It may cause political and social stability in case the revenue is not spent properly.

### **TAXABLE CAPACITY.**

- Refers to the ability of a nation to obtain revenue from tax payers necessary for its expenditure.
- It is the ability of the tax payer to pay the taxes imposed on him
- Refers to the limits of a country capacity to accept and absorb taxation.

### **THE FOLLOWING ARE FACTORS AFFECTING TAXABLE CAPACITY.**

1. The real wealth of a country i.e. resources
2. The size of population. The higher the population the higher taxable capacity this depends with the fraction of population engaged in economic activity
3. The level of economic development of the country
4. The possibility of tax evasion and corruption
5. The level of income when is low the lower the taxable capacity
6. The attitude of the tax payers in the payment of taxes
7. Income distribution in the country
8. Level of inflation.

**Qn. Discuss why the taxable capacity is low in less developed country**

**Qn. Discuss the measure of the country can adopt to widen tax base and increase taxable capacity.**

## **II. PUBLIC EXPENDITURE.**

Refers to the spending by the government .it is categorized into two groups.

1. **Recurrent expenditure.**

Refers to government expenditure on public consumption like in education, salaries, health etc

## 2. **Development expenditure**

Is the expenditure by government on development projects like roads, in communication etc.

### **Roles of government expenditure (why should spend?)**

1. To regulate economic activities
2. It influencing the allocation of resources
3. To enable government to maintain its enterprises and property
4. Provide essential goods and services to the public.
5. Stabilizing the economy
6. Motivating the government employee in terms of reward, seminar etc
7. To balance the national development.

## **III. NATIONAL BUDGET**

- It is the estimate of the government revenue and expenditure within a given year (financial year)
- This is a statement showing anticipated receipts and anticipated payments.

### **TYPES OF NATIONAL BUDGET.**

There are two main types of government budget (Balanced and unbalanced budget which includes (Deficit surplus budget)).

#### **1. Surplus budget**

This refers to budget in which the anticipated revenue is greater than anticipated expenditure. This surplus budget implies that

1. There is going to be a reduction in price level
2. There is reduction in money supply
3. There is reduction in economic activities
4. There is going to be grants and gifts to other countries

This kind of budget is not found in LDCs.

### **Qn, Why do countries plan for surplus budget, what are the objectives of surplus budget.**

1. They are aimed at reducing money supply (circulation)
2. To enable government finance development projects in the future
3. To enable government give grants, loans to other countries
4. To correct balance of payments

5. To discourage consumption of some goods
6. To control inflation through reducing aggregate demand
7. To help the government to get money and repay debts.

Surplus budget may lead to the following problems;

1. Unemployment
2. Depression
3. Decrease in money supply leading decrease in investment and saving
4. Decrease in aggregate demand leading to decrease in production
5. Increase in tax rate to maximize revenue.

### **Deficit budget**

Refers to the budget in which the anticipated revenue is less than anticipated expenditure. It occurs when government estimated expenditure is greater than estimated revenue. This is mainly occur in developing countries like Tanzania.

**Balanced budget** is when the anticipated budget is equal to anticipated expenditure. Government estimated revenue Government proposed expenditure. Most of the classical economist advocated balanced budget, which was based on the policy of 'line within means'. According to them, government revenue should not fall short of expenditure.

**This implies that;**

1. The government is going to borrow more money within a financial year
2. There is going to be an increase in money supply resulting from increase in expenditure
3. There will be increase in price level
4. There will be increase in aggregate demand and unemployment
5. The government may sale its assets.

**Qn. Why having a deficit budget in LDC'S.**

1. A deficit budget is aimed at increasing level of aggregate demand
2. Increase level of supply
3. Aim at controlling deflation
4. Reducing the tax burden
5. Encouraging borrowing
6. Shifting the economy from depression recovery
7. Increasing economic activities

**Qn. What are the causes of budgetary deficit in Tanzania**

*Qn. Discuss the functions of the budget*

## ***PUBLIC DEBTS.***

*Is the total borrowing by the government. This includes internal and external borrowing.*

### ***CLASSIFICATION OF DEBTS***

#### ***1. INTERNAL DEBTS.***

*Is the total money which the government borrows from individual and institutions within the country.*

#### ***2. EXTERNAL DEBTS***

*Is the borrowing of a money outside the country e.g. from WB, IMF, ADB (African development bank)*

#### ***3. REPRODUCTIVE DEBTS.***

*These are debts which the government uses for productive activities that will generate revenue to repay back the debts.*

#### ***4. NON REPRODUCTIVE DEBTS (dead weight)***

*This are debts used to finance activities that do not give the return e.g. weapons.*

#### ***5. SHORT TERM DEBTS.***

*This is debts paid within short time.*

#### ***6. LONG TERM DEBTS***

*These are debts paid after a long period of time for example 10year – 50year.*

#### ***7. A FUNDED DEBTS***

*These are debts in which a specific time of repaying debts is not fixed to get the loan.*

#### ***8. UN-FUNDED DEBTS***

*These are debts in which date of redemption is stated while receiving the loan.*

#### ***9. VOLUNTARY AND COMPOLSORY DEBT***

### ***REDEMPTION OF PUBLIC DEBTS***

***Redemption of public debt*** refers to the payment of public debts

## **WAYS USED IN REDEMPTION OF PUBLIC DEPT.**

### **1. REPUDIATION.**

*Repudiation is form of debt redemption where the government refuse to pay debts.*

### **2. BY CONVERSION.**

*Is the form of debts redemption where the government takes new loan with low interest and paying the previous loan with higher interest.*

### **3. NEGOTIATIONS ON DEBTS.**

*This refers to cancellation of a debt*

### **4. USE OF SURPLUS BUDGET**

*Where the expenditure is less than revenue and extra amount of money is left for paying debt.*

### **5. CAPITAL LEVY.**

*Is where the government imposes taxation on asset like building and the revenue is used to pay the debts.*

### **6. SINK FUND**

*Is the situation where the government invest a given amount of money in the bank to get compound interest and hence use the amount obtained to pay a debts.*

### **7. PRIVATIZATION OF PUBLIC GOODS.**

*The money obtained from privatization is used for debts repayment.*

### **8. USE OF GRANTS AND GIFTS RECEIVED**

### **9. SELLING SECURITY TO THE GOVERNMENT**

### **10. USE OF ACCUMULATED FOREIGN RESERVES.**

## **CAUSES AND JUSTIFICATION OF PUBLIC DEBTS.**

***Qn. Why do LDC's government depend on borrowings?***

*-To increase revenue since tax revenue is not enough to finance government activities in LDCS.*

- To reduce the tax burden from tax payers
- To correct balance of payment deficit,
- To reduce printing of more money by the government to avoid inflation.
- In order to overcome natural calamities such as drought etc.
- To help the government attain economic growth through the finding of more economic activities hence economic growth
- Enable the government persuade its development plan
- To balance the budget and cover budgetary deficits.
- To enable the government repay loan conversion
- To control economic depression through increase in aggregate demand result from increase in unemployment opportunities.

***Qn. Discuss the roles played by public borrowing in LDC.***

- It leads to over dependency
- It reduces money available for consumption and investment.
- Debts worsen the country balance of payment position.
- If the debt is not used reproductively it becomes a burden to the government and its people.
- Most of the debts are always in the form of a tied aid i.e. debt with conditions (strings attached)
- When the debt is long-term its burden is shifted to another generation
- There is a burden of paying interest and other cost in debts administration.

***Qn. Discuss the measure your country is using to reduce debt burden?***

***Qn. Discuss why external debts have been increasing instead decreasing in LDCS***

### ***FISCAL POLICY.***

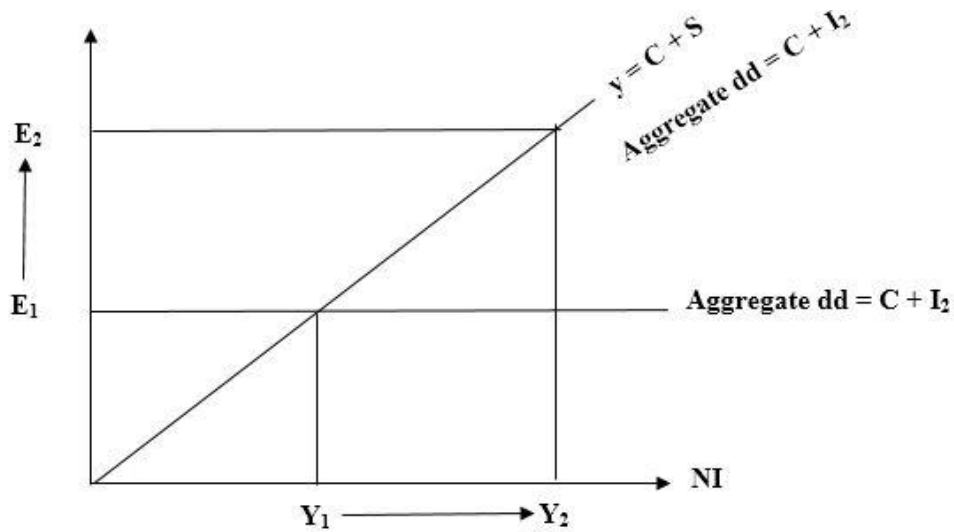
*-This is the use of taxation, government expenditure and public borrowing to influence the economic activity of a given country.*

*How fiscal policy work (mechanism of fiscal policy)*

*It works in two ways i.e. expand economic and to contract economy.*

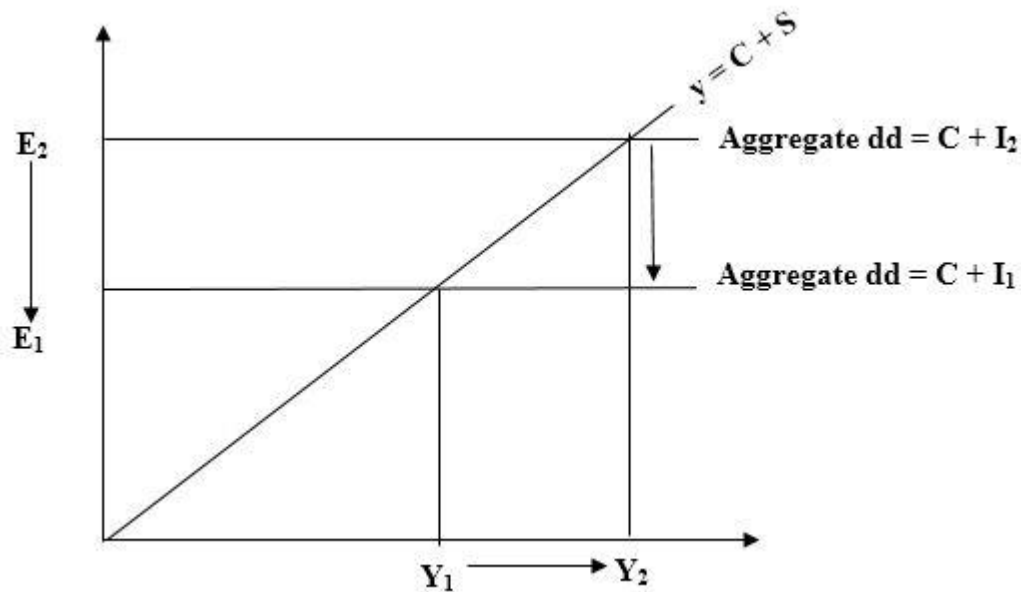
### **EXPANSION FISCAL POLICY**

*This is a situation where there is increase of government expenditure and decrease in tax. It is aimed at increasing aggregate demand.*



### **II. CONTRACTION FISCAL POLICY.**

*It aimed at reducing aggregate demand where there is increase in tax and decrease in expenditure.*



*Qn. Discuss how fiscal policy can be used to bring economic development hint (use roles of tools of fiscal policy)*

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## FINANCIAL INSTITUTION

- These are institution which stands between surplus spending unit and deficit spending units.
- These are institution which acts as a goal between transferring funds from those who have surplus to those who are spending.

### THEY PLAY THE FOLLOWING ROLES

1. They transfer funds from those with surplus to those who are in need
2. They facilitate the pooling of risks.
3. They provide the public with more liquid and less risks on assets
4. They help to increase efficiency by applying special technology and other assistance in investment
5. They increase the liquidity of financial institution by giving loans.

### FINANCIAL INTERMEDIARIES ARE CATEGORIZED INTO TWO

#### 1. Banks

These are financial institution which provide short term loan, accept and maintain deposit, undertake less risk investment, create credit and their aimed at making profit.

#### 2. Non banking financial institution (NBFIs)

- These are institutions that carry out financial activities by their resources and are not directly from the savers as debt instead they mobilize the public saving for providing financial services.

Are institutions that provide banking services without meeting definition of bank for example development bank, life insurance Company, PPF, NSSF, Building society, post offices, saving banks etc.

### DIFFERENCE BETWEEN BANKS AND NON BANKS.

Banks	Non Banks
i)They operate different account for their customer example saving, fixed and current account	-They do not operate account for their customers



ii) Bank use saving to advance loans	
iii) They make profit from loan in form of interest	- They do not use saving to advance loan
iv) Banks are aimed at making profit	- They depend on revenue obtained from investment.
	- They are not aimed at profit making.

Banks can be categorized into

1. Commercial Banks
2. Central Banks
3. Saving Banks
4. Specialized Banks
5. Merchant Banks

### 1. COMMERCIAL BANK

Is a profit making financial institution, it obtains its profit from charging high interest on loan, charging a commission on service rendered and investing in short term and medium investment.

### FUNCTION OF COMMERCIAL BANK

1. Accepting and keeping deposits
2. Maintaining different accounts, these are saving current and fixed deposit a/c
3. They keep valuable articles and documents in self custody
4. They give loans and overdraft to customers.
5. They exchange currency
6. They facilitate quick and payment through cheque, standing orders
7. Banks manager deceased customer property and distribute it according to the will
8. They give advice to customers on investment
9. They assist the government in receiving money from tax payer
10. They create credit
11. They help central bank to implement monetary policy
12. They acts as referees to credit worth customers

### 1. NATIONAL BANK OF COMMERCE (NBC)

It was established in 1967 after the Arusha Declaration following the nationalization of private foreign bank. NB was aimed at solving the following problems:

1. The problem of low finance to domestic sector
2. There was too much domestic credit to foreigners

3. There was low savings mobilization to citizens
4. There was high level of dependency on foreign managerial skills
5. There was lack of support to the government during deficit budget

#### **FUNCTIONS OF NBC BY THEN.**

1. To provide loans to investors
2. To mobilize savings
3. To transfer funds/money from one area to another
4. To provide technical advice to the investors
5. Custodian of valuable commodities
6. It provides other commercial bank services.

After privatization in 1997 NBC was divided into two

1. **National bank of commerce limited ( NBC 1997 ltd)**
2. **National micro finance bank (NMB)**

NBC was to provide services to big businessmen while NMB was to provide services to low income earners and small businessmen

#### **1. COOPERATIVE AND RURAL DEVELOPMENT BANK (CRDB)**

It was established in 1947 for provision of local development loan fund which was to assist food production and for African productivity loan fund in assisting European farmers.

#### **FUNCTIONS OF CRDB OF 1947.**

1. To promote rural development
2. To monitor projects
3. To ease the purchase of crops in the rural areas
4. To provide technical advice to farmers
5. To provide loans to cooperative unions.

#### **2) SPECIALIZED BANKS**

Are banks that deal with specific function or specific sectors.

They include:-

i) **T.I.B** – Tanzania Investment Bank, the bank was established in 1971 to bring all means of production to the public. Its other functions were as follows;

- a) To finance large scale agriculture
- b) To provide advice on industrial development

ii) **T.H.B** – Tanzania Housing Bank: The bank was established 1973 in order to receive deposit and provide account services to provide all banking services and provide credit for residential and commercial premises.

## CREDIT CREATION

This is a process through which commercial banks use cheque to expand the volume of money lent.

**NB: The expanded credit is only in the form of book entry.**

**Example:-**

Assuming the cash ratio/ reserve ratio is 20% and initial deposit is 1000. When people get loan they deposit cheque in their a/c in the same bank. If there are 4 people who are able and willing to borrow money the credit creation process will be follows.

Person	New deposits	Reserve current ratio	New loan
A	1000	200	800
B	800	160	640
C	640	128	512
D	512	102.4	409.6

Total credit is equal

$$(\text{TOTAL AMOUNT DEPOSITED}) \text{ OR } (\text{RESERVE RATIO}) = \frac{1000}{5000} = \frac{20}{100}$$

**The number of times the money increase is called the credit multiplier**

## LIMITATION OF CREDIT CREATION

1. Leakage of money out of bank system
2. Liquidity ratio / reserve ratio, if ratio is low credit creation in high
3. Illiteracy and altitude where by some people do not keep money in the bank
4. Regulation of central bank which reduce the amount lent
5. High interest rate which discourage borrowing
6. Very low interest rate which discourage savings
7. Lack credit worth. Customers making it difficult to give out loans.

## PROBLEM FACING COMMERCIAL BANKS.

1. Shortage of funds for loans to customers

2. Illiterate customers
3. Insecurity of commercial banks, constant invention by robbers
4. Most banks are under capitalized hence the level of operation is restricted
5. Inflation discourages lending
6. Most of the bank are allocated in towns facing steep competition
7. Collapse of banks resulting from failure of shareholders to pay back the loans

### **3. CENTRAL BANK.**

Is a financial institution which controls all other financial institution and implements monetary policies. The central bank of Tanzania (BOT) was established 1965 replacing the existing East Africa currency board. The Bank of Tanzania BOT started issuing currency in 1966.

#### **FUNCTIONS OF B.O.T**

##### **1. Banking function, the BOT does the following**

1. It acts as the clearing houses for commercial banks
2. Banker to the government in terms of account and loan
3. Banker to other banks ( all commercial bank should have a/c in central bank)
4. It is a lender of last resort
5. Issuing of currency

##### **2. Development function the central bank stabilize the economic by**

1. It formulate and implement monetary and fiscal policy
2. It supervises commercial bank and non banks in their activities
3. It provides employment

##### **3. Domestic monetary management functions**

- BOT acts as adviser on all financial institutions
- It is responsible for financing the government in case of deficit budget
- It manages all government debts

##### **4. External monetary management function**

1. It controls the foreign currency and exchange rates.

#### **Difference between central bank and commercial bank**

Commercial bank	Central bank
-----------------	--------------

1. They aimed at making profit	They aimed at serving the public
2. They provide safety custody for valuable goods	Does not provide safe custody for valuable goods
3. They create credit	They do not create credit
4. They do not control financial institution	They control other financial institution
5. They accept deposit from public	They accept deposit from government institution and banks
6. Take care of property of the deceased	They so not take care of the property of deceased
7. They do not print money	They print and organize printing
8. They are owed by individuals and government	Owned by the government

**Qn. 1. Discuss the objectives of monetary policy**

**2. What are the problems of implementing monetary policy in LDC'S.**

### **NONE BANKS FINANCIAL INSTITUTIONS.**

Non banking institutions perform the following roles

1. They advance loan to entrepreneur
2. They invest on physical investment such as buildings, factories etc
3. They stimulate and promote financial and capital market through investment in shares.
4. They provide socio security
5. They provide life assurance and pension services to the public
6. They mobilize saving among the public
7. They help to control poverty (poverty alleviation.)

### **NATIONAL INSURANCE COMPANY (N.I.C)**

It was established in 1967 after Arusha declaration which speculates nationalization policies.

The main objectives of NIC where

1. To collect premium from member/ clients
2. To invest in productive activities like buildings
3. To provide compensation to client against risks
4. To fight against poverty alleviation
5. Income distribution

**Qn. Discuss the roles of PPF?**

Privatization of financial institutions.

1. To reduce the government burden
2. To increase the amount of profit
3. To eliminate bureaucracy
4. To make the institution more efficient in their operation
5. To increase capital hence expand their institution
6. To allow the use of advance technology
7. To enable the consumer to make choice.
8. To reduce embezzlement of fund.
9. To reduce political interference brought about the existence of public institutions.
10. To allow technical assistance in the management from abroad

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## MARKETING AND DISTRIBUTION

**-Marketing:** refers to making communication about products or services. A purpose of which is to encourage the receipt of the communication to purchase/ use the product of the service

-Marketing involves finding what customers want, setting out to meet their needs provided and it can be done at a profit.

**-Distribution:** is a commercial activity of transporting and selling goods from a producer to a consumer. It is about how to get the product in the hands of consumer.

**-NOTE:**

The topic of distribution tries to identify the role played by cooperatives, crop authority, board, agencies, corporation etc.

In Tanzania marketing and distribution is done by;

1. **Cooperative societies**
2. **Marketing board**
3. **Internal and external trade authority**
4. **Private companies.**

## **COOPERATIVE SOCIETIES.**

- A cooperative societies is association of people who join voluntary with some common goal or objective
- Is an autonomous association of person united voluntary meet their common economic, social and cultural needs.

Cooperative societies are based on the following principles;

1. **Open membership**
2. **Limited interest on capital**
3. **Democratic control**
4. **Cooperative education for all members**

## **TYPES OF COOPERATIVE SOCIETIES.**

Societies are categorized into two main groups

1. **According to membership registration**

This includes primary cooperative society, secondary cooperative societies, national cooperative society and international cooperative society.

2. **According to their services**

This include saving and credit cooperative society, marketing cooperative society.

- Consumer cooperative society
- Transport cooperative society
- Handcraft cooperative society

## **ROLES OF MARKETING COOPERATIVE SOCIETY**

1. They help formers to market their produce
2. They own and run farms
3. They increase the bargaining power of their members
4. They protect farmers against exploitation by middlemen
5. They provide education to the members
6. They provide subsidies of inputs to formers
7. They provide employment in transport and marketing
8. They provide advice to farmers
9. They provide social services to the members

## **PROBLEMS FACING MARKETING COOPERATIVE SOCIETIES.**

1. Government interference
2. Embezzlement of funds by leaders
3. Lack of skilled labors

4. Problem of mismanagement due to lack of managerial skills
5. Dishonest members where some of them are poor
6. Shortage of credit facilities to member
7. Inadequate transport, storage and packing facilities
8. Corruption
9. Tribalism

## **MARKETING BOARDS.**

Are trading agencies established by the government to control the marketing of primary and processed agricultural commodities.

There two main categories of marketing boards;

1. **The export marketing board**
2. **Statutory boards**

## **II) STATUTORY BOARDS.**

This is a marketing board that involved in market of food stuffs e.g. maize, cashew nuts etc

Examples of marketing boards in Tanzania;

1. **Cotton marketing board**
2. **Coffee board**
3. **Maize produced board**
4. **Cashew nut board**

## **ROLES OF MARKETING BOARDS**

1. Buying product from farmers
2. Setting out prices with the help of the government
3. Storage and collection of produce
4. They offer transport from the producers to the warehouse
5. They offer advices to producers on mechanization and new technology
6. They control the production of the produce
7. They advice the government on importation and exportation products
8. They conduct research on marketing of agricultural product
9. They conduct selling of produce.

## **PROBLEMS FACING MARKETING BOARDS**

1. The problem of overproduction
2. Price fluctuation
3. Government interference
4. Competition from private buyers
5. Delay of payment to farmers which discourages crop product
6. Lack of enough market for the produce
7. Low quality produce as result of poor technology



8. Problem of mismanagement of marketing boards.

### **BOARD OF INTERNAL TRADE (BIT)**

It was established in 1973 replacing state trading company. The board has the following functions;

1. Conducting internal market research
2. Advising the businessmen and government on trading activities
3. Organizing internal trade fair and exhibition
4. It sets and revises internal trade policies
5. They supervise all internal trade activities
6. They provide employment to qualified person in the board

### **BOARD OF EXTERNAL TRADE (BET)**

The following are the functions of **BET**;

1. They conduct market research
2. They provide training of personnel in foreign trade
3. They provide information on export commodities requiring businessmen from abroad
4. They provide consultation services
5. They participate in trade outside the country
6. They look for market for produce abroad

### **PRIVATE CROP BUYERS.**

Are businessmen, who buy crops directly from producers, they can be in the form of individual or companies.

### **ADVANTAGES OF PRIVATE CROP BUYERS.**

1. They provide incentives to farmers
2. They buy and pay in cash
3. They reduce bureaucracy in buying of crop
4. They increase competition in buying of crops
5. They provide subsidies and other financial assistance to the farmers
6. They reduce the producer's problems of storage by buying immediately of harvesting.

### **DISADVANTAGES OF PRIVATE CROP BUYERS.**

1. Private buyers lead to instability in price.
2. Private buyers buy produce at low prices to maximize profit
3. They do not provide education to producers
4. Private buyers do not provide infrastructure services like those provided by cooperative and market board.
5. Private buyers reduce the strength of cooperative society
6. They do not help to improve the quality of the produce
7. Private buyers do not provide inputs to producer like cooperative society.
8. The existence of private crop buyers has led to decline of quality some product because sell crops before they mature at low price.
9. The existences of private buyer have led to high level of theft of produce.

## **TRANSPORT AND COMMUNICATION.**

Transport; is a movement of a good or service from one place to another.

The following are the modes of transport.

There are mainly three forms or modes of transport namely.

1. **Land transport**
2. **Air transport**
3. **Water transport.**

### **LAND TRANSPORT.**

It includes the following means of transport human portage, animal transport, road transport

#### **Human portage**

It consider/ means of transport where human beings acts as unit of carriage (vessels)

- It is flexible
- It is always available and can be provided by anybody
- It has the lowest cost
- It can be used in area where other means of transport cannot be used

### **DISADVANTAGES**

- It is very slow
- It is limited to a given types of good

#### **Animal transport**

This is means of transport which uses camels, horses, donkey, bulls as a means/ units of carriage.

### **ADVANTAGES**

- Its flexible
- It can be used in hostile areas
- It is cheap
- It is faster compared to human portage
- Its slow compared to other means of transport
- It is used for specific goods
- Not suitable for long distance

#### **Road transport**

This involves the use of vehicles.

### **ADVANTAGES**

- It is fast for short distance
- It cheap for short distance
- It is flexible compared to rail transport and air water
- It provide for consumer choice by offering variety of unity of carriage
- It does not require very strict time schedule compared to trainer aeroplane.
- Its available in many areas including rural areas
- It reduces damage of goods resulting from quick deliberate

#### **DISADVANTAGES.**

- It is slow over long distance
- It has risk of theft and hijacking by highway robbers
- It is expensive for long-distance.
- It carries limited loads compared to other means
- Road construction is expensive
- Lead to accidents
- It is affected by weather condition

#### **Railway transport**

#### **ADVANTAGES**

- It is cheap over long distance
- It can carry bulk goods
- It is less affected by weather condition
- It provides warehousing services at different terminals
- It follows a time schedule.

#### **DISADVANTAGES**

- Not flexible
- It is slow
- It is expensive to build a railway line
- Not suitable for short distance

#### **Pipe lines.**

This refers to use of pipe in transporting liquids and gases i.e. Tazama

#### **ADVANTAGES**

- It is convenient
- After construction of pipeline, it's cheap to maintain
- It cover a long distance
- It carries a big volume of liquids and gases
- Its suitable and reliable
- Extension can be made to make it flexible

#### **DISADVANTAGES.**

- The initial cost of constructing a pipeline is very high

- It has high risks of destruction
- If a leakage is not detected it can be very dangerous
- They cannot carry solid goods

#### 1. WATER TRANSPORT.

- It is cheap no cost construction
- It carries bulk goods
- It has less risks of accidents
- It is good for inflammable goods such as fuel
- Modern flight are well equipped for protection with containerization and refrigeration
- It is comfortable

#### DISADVANTAGES

- It is not flexible, it is geographically determined
- It is very expensive to build a ship
- Not suitable for passengers over long distance
- In case of an accident there is higher possibility of a great loss of life
- It causes delay in delivery
- It is not economical for small quantities of goods.

#### AIR TRANSPORT

#### ADVANTAGES

- It is the fastest
- It is free from physical barriers
- It enables producer to deliver their good easily
- It is suitable and comfortable over long distance
- They have well developed packaging methods

#### DISADVANTAGES

- It is expensive to build or buy a plane
- It is very expensive to use
- It is not flexible
- It is accidents are fatal i.e. bring great loss of life
- It is not reliable during bad weather condition
- It has high risk of high jack
- It follows a schedule timetable

#### FACTORS TO CONSIDER WHILE CHOOSING A MEANS / MODE OF TRANSPORT

- The distance
- The cost of transport
- The agency of the matter
- The nature of the good to be transport i.e. the size
- The means of transport available
- The terminal of the passengers

## **COMMUNICATION**

Is the transfer of information from one person or point to another

The following are type's communication;

### **1. ORAL COMMUNICATION**

Is the convention of information through mouth

### **2. WRITTEN COMMUNICATION**

Is the convention of information through written documents

### **3. VISUAL COMMUNICATION**

This involves use of picture

### **4. AUDIOVISUAL COMMUNICATION**

**Note:**

Generally is composed with written and Visual communication in which verbal communication involves the use of words (face to face) and Non verbal involves the use of gestures,symbols and sign language like Tanzania sign language (TSL)

**5.VERBAL COMMUNICATION**-face to face ,telephone,radio,television and other media.

**6.NON VERBAL COMMUNICATION**-body language,sign language,gestures,how we dress or act.

**QN. Discuss the roles of transport and communication in the economy**

## **TRANSPORT AND COMMUNICATION PLAY THE FOLLOWING ROLES**

1. It helps to create a market
2. It bridges the gap between producer and consumer
3. Enables contact to exist between producer, seller and consumer
4. It increase mobility of labor and other factor of production
5. It provide employment
6. It enable the transfer of technology and trading information
7. It make goods available where needed
8. It help to change utility of goods from one place another
9. It brings about consumers choice

## **PROBLEM FACING TRANSPORT AND COMMUNICATION**

1. Lack of funds to construct and maintain road railway unit of carriage
2. Increasing number of accidents
3. Poor weather conditions
4. Increasing cost of fuel
5. Lack of enough goods/ products to transport
6. Remoteness of some areas.

## INTERNATIONAL TRADE

- Is the trade taking place between two or more countries.
- **Bilateral trade** – Is the trade taking place between two countries
- **Multilateral trade** : Is the trade taking place between more than two countries.
- **Domestic trade**: Is trade involving exchange of commodities within the country.

**Qn:- What is the difference between International and domestic trade?**

**The following are the differences:-**

1. Domestic trade few document while international require many.
2. Domestic trade requires use of domestic currency while International requires use of other currency.
3. Domestic trade does not require use of very standardized goods while International trades require standardized goods with quality.
4. There are few barriers to domestic trade while there are many to International trade.
5. There is free movement of production factors i.e. capital and labor in domestic trade. There are restrictions to mobility of factors of production in International trade.

**Reasons for International trade “It must for International’ trade” Discuss:-**

1. Different countries are endowed with different natural resources not found in other countries.
2. There is a different in human skills among the countries, talents and creativity leads to production of different commodity which has to be exchanged.
3. There is an even distribution of capital and technology. Countries with high capital and high level of technology will produce and export.
4. The benefits from trade in terms of revenue, profits and International relation.

**Importance of International trade:-**

1. It increases competition and quality of goods.
2. In enables countries to dispose surplus
3. It brings foreign exchange.
4. In increase International relations
5. It leads to specialization in production
6. It leads to mobility of factors of production especially labor and capital.
7. It leads to expansion of market
8. It helps to improve the balance of payment
9. It increases consumer sovereignty

### DISADVANTAGES OF INTERNATIONAL TRADE

1. It affects the growth of infant industry

2. It leads to importation of harmful products
3. It leads to over reliance on imported commodities
4. It leads to over reliance on imported commodities
5. Importation can lead to inflation i.e. Imported Inflation
6. It leads to capital flight in case of foreign investment
7. It leads to repatriation of profit.
8. It can lead to political blackmail where countries are forced to adopt policies due to over dependency.

**Qn.- 1. International trade is must, Discuss**

1. Discuss the problem faced by developing countries in international trade.

**Barriers for International trade:-**

Barriers are limitation or difficulties which limit smooth flow of commodities in International trade. They can either be natural or artificial (man made).

1. **NATURAL BARRIERS**

- (i) **GEOGRAPHICAL BARRIERS**

Long distance implies high cost of transport affecting the smooth flow of commodities.

- 1/ Social and cultural difference
- 2/ Changes in the weather condition (world climatic pattern)
- 3/ War uprising
- 4/ Ignorance of goods and services available elsewhere

2. **ARTIFICIAL (MAN MADE) BARRIERS**

Tariffs (custom duty); It's a tax which government imposes on goods entering the country. It is aimed at controlling imports by making them expensive. It can either be specific or ad valorem.

1. Exchange controls; Businessmen exchange commodities using the currency of the exporting country. The government hence restrict trade by controlling the amount of foreign currency to be used.
2. Uses of subsidies; the government can give subsidy to exporters to increase export and reduce import.
3. Use of Quota; is a situation where the government fixed a certain amount of goods to be imported through licensing.
4. Total ban (embargoes); is situation where government restricts completely the importation of a given commodity.
5. Custom Draw backs
6. Administrative restriction; is a situation where the government refuses to disclose important information about a product to foreigners so as to protect local industry from competition.

**Reasons for restricting import:-**

1. To correct the balance of payment disequilibrium i.e. tariffs are used to correct BOP deficit by making import expensive.
2. To protect infant industries which cannot withstand competition?
3. To promote employment of resources.
4. To reduce dumping of inferior goods.
5. To protect declining of industries
6. To promote key/major industries particularly Agriculture and Tourism
7. To diversify the economy

**Qn: Discuss the argument against protectionism:-**

**The following are the argument against protectionism:-**

1. It reduce customer sovereignty
2. It discourages competition
3. It leads to low quality of goods.
4. Import tariffs (custom duty) can lead to inflation as result of high price in import.
5. It lowers the volume of trades
6. It may lead to unemployment resulting from lack of market.
7. It is against the theory of comparative advantage and absolute advantage.

## **THEORIES OF TRADE**

**There are two theories of trade namely:-**

1. Theory of absolute advantage
2. Theory of comparative advantage.

### **1. THEORY OF ABSOLUTE ADVANTAGE**

This theory was advocated by Adam Smith. It states “A country is said to have absolute advantage in the production of a commodity if it can produce that commodity more efficiently than the other country”.

**The theory is based on following assumptions:-**

1. There two countries and two commodities.
2. Labor is homogenous in both countries
3. There is no difference in technology in both countries
4. Mobility of factors of production is perfect
5. There is free trade
6. There is no / transport cost
7. There is perfect competition
8. The valued of commodity is determined by amount of labor units used in its production.



**For example:-**

Item	Uganda output per labor	Tanzania output per labor
Coffee	15 kg	2 kg
Tea	4 kg	10 kg

From the above Uganda has absolute advantage in the productive of coffee while Tanzania has absolute advantage in Tea. One unit of labor can produce 15 kg of coffee and only 4 kg of tea.

- One unit of labor in Tanzania can 10 kg of tea and only 2kg of coffee. Both countries can gain in trade if each would specialize in the production in which it has absolute advantage.

If one labor in Uganda can produce 15 kg of coffee by specializing. Uganda can produce 30 kg of coffee and if Tanzania would specialize in production it can produce 20 kg.

It can be illustrated as follows:-

**After specializing:-**

Item	Uganda output / labor	Tanzania output per labor
Coffee	30kg	0kg
Tea	0 kg	20 kg

**Output before trade & specialization:-**

Item	Uganda output per labor	Tanzania output per labor	Total output
Coffee	15 kg	2 kg	17 kg
Tea	4 kg	10 kg	14 kg

**Output after trade and specialization**

Item	Uganda output per labor	Tanzania output per labor	Total output
Coffee	30 kg	0	30 kg
Tea	0	20 kg	20 kg

**Specialization would lead to:-**

- An increase in output in both countries
- It would lead to full utilization of resources of both countries
- All countries will gain from exchange of commodities.

**Qn. Given the following information:-**

	<b>Production / Fuel</b>	<b>Labor per units Food</b>	
Country A	10	5	State which of the two countries has absolute advantage in production of either / commodity
Country B	8	2	

## II. THEORY OF COMPARATIVE ADVANTAGES

Is a condition in which a country produces some goods or services at a lower cost in terms of opportunity cost of other good and have services which could have been produced.

It is based on comparison of production cost and it is expressed in the form of comparative ratio which gives the opportunity cost.

It state that “ If one country is less efficient in the production of both commodities and another country is more efficient in both commodities the two countries can benefit from trade by specializing in the production and export of commodity in which it has a low opportunity cost.”

**For example:-**

	<b>Output per labor country A</b>	<b>Output per labor country B</b>
Coal	3	9
Wheat	30	40

According to the above data country B has comparative advantage in the production of both products coal and wheat this is because one unit of labor in country B produces one units of coal compared to 3 units of coal produced by one unit of labor in country A.

**According to comparative advantage the two countries can trade and gain from trade as follows:-**

-	<b>Country A</b>	<b>Country B</b>
Coal	$30/3 = 10$	$40/4 = 4.4$
Wheat	$3/30 = 1/10 = 0.2$	$9/40 = 0.0225$

Country A has comparative advantage in the production of wheat while country B has comparative advantage in the production of coal.

**Example 2:**

**Given the following production per unit labor:-**

	Fuel	Food
Country A	10	5
Country B	20	2

	Fuel	Food
Country A	$5/10 = \frac{1}{2} = 0.5$ of food	$10/5 = 2$ of fuel
Country B	$2/10 = 1/5 = 0.2$ of food	$10/2 = 5$ of fuel

Country B has a comparative advantage in production of fuel while Country A has a comparative advantage in production of food.

**Qn: Your given**

Country	Cotton (Tones)	Sisal (Tons)
Tanzania	4	2
Sudan	12	4

The figure represents Input quantities per unit of output of the corresponding commodities.

1. Which country has absolute advantage in production of (i) sisal (ii) Cotton, give reasons.
2. Which country has comparative advantage in production of (i) sisal (ii) cotton, give reasons.
3. With reasons suggest how the two countries can specialize in production of two commodities so as to encourage between them.

**Assumption of theory of comparative advantage:-**

1. It assumes that it has no transport cost
2. Labor are homogenous
3. There is free trade
4. There is perfect competition
5. There only two countries or nations.
6. Factors of production are perfectly mobile.

**Criticisms against the theory of cooperative advantage:-**

1. The assumption of two countries and two commodities is unrealistic.
2. Labour is not homogenous
3. Transport cost must be involved

- There are other factors of production which are important compared to labour.

#### Application of comparative advantage theory:-

- It encourages specialization
- It leads to balance of payment between the trading countries.
- It encourages free trade
- It provides a basis for trade (international trade).
- It enables proper utilization of resources.
- 

#### Terms of Trade (T.O.T):-

- Is the rate at which a country goods (export) are exchanged against those of other country(import)
- It is the **ratio** between price index of **export and price index of import**.

#### Terms of Trade is given by:

$$\text{T.O.T} = (\text{PRICE INDEX OF EXPORT})/(\text{PRICE INDEX OF IMPORT}) \times 100$$

$$= \text{PX}/\text{PM} \times 100$$

Where;

**PX is price index of export**

**PM is price index of import**

Qn:- Suppose from 1980 – 1990 the export price index of Tanzania rose from 100 to 150 while the import price index rose from 100 to 170 .

Calculate the **terms of trade**.

**Soln:**

$$\text{T.O.T (1980)} = \frac{\text{PX}}{\text{PM}} \times 100 = \frac{100}{100} \times 100$$

$$= 100\%$$

$$\text{T.O.T (1990)} = \frac{150}{170} \times 100 = 88.2\%$$

In 1990 terms of trade in Tanzania worsen, in had to export of large physical quantity of goods to buy the same amount of import goods.

Qn. 2: Given the following prices of import and export, Calculate the terms of trade:-

YEAR	Export price Average price	Import prices Average price
1		

1990	540	4500
1991	594	6480
1992	621	4860
1993	648	5400

**Calculate price index:-**

**Soln:**

$$\text{Price index} = \frac{P_n}{P_o} \times 100$$

$$\text{Price index } 1990 = 100\% \quad \text{Price index (M) } 1990 = 100\%$$

$$\text{Price index (1991)} = \frac{594}{540} \times 100 = 120\% \quad \text{Price index (1991)} = \frac{6480}{4500} \times 100\% = 144\%$$

$$\text{Price index (1992)} = \frac{621}{540} \times 100 = 115\% \quad \text{Price index (1992)} = \frac{4860}{4500} \times 100\% = 108\%$$

$$\text{Price index (1993)} = \frac{648}{540} \times 100 = 120\% \quad \text{Price index (1993)} = \frac{5400}{4500} \times 100\% = 120\%$$

**Total price index:-**

Year	Export	Import	
1990	100	100	TOT 1990 = $P_X = 100 \times 100 = 100\%$ $P_M = 100$
1991	110	144	TOT 1991 = $P_X = 110 \times 100 = 110\%$ $P_M = 144$
1992	115	108	TOT 1992 = $P_X = 115 \times 100 = 115\%$ $P_M = 108$
1993	120	120	TOT 1993 = $P_X = 120 \times 100 = 120\%$ $P_M = 120$

Different ways of measuring term of trade (T.O.T)

### 1. Net barter / commodity terms of trade

Is the ratio of price index of exports and price index of imports

T.O.T Net barter =100

## 2. Income term of trade / capacity to import.

It is the ration between the product price index for export and quantity of export to the price index of imports.

Income T.O.T =  $PX Q_x / P_m \times 100$

Where,  $O_x$  is quantity of export =  $V_x / PX$

$V_x$  = volume of export

$PX$  = price index of export

(iii)

Gross barter T.O.T =  $Q_x / Q_M \times 200$

Where;  $Q_x$  is quantity of export

$Q_M$  is quantity of import

### Favorable terms of trade:-

It occurs when a country export prices rises while the import prices decline or remain constant. This implies that a country can get more import by exporting the same quantity of export.

### Unfavorable terms of trade:-

Countries terms of trade are said to be unfavorable when the price of export declines or remain constant while the price of import rises. This implies that there is less foreign exchange coming from export.

### Balance terms of trade:-

Balance terms of trade occurs when terms of trade between two countries is equal to one.

### Determinants of term of trade:-

These are the factors which determine whether terms of trade are favorable, unfavorable or balance.

## 1. Forces of demand and supply

When the demand of export raises the price of export increases leading to favorable T.O.T and Vice versa

**2. The degree of monopolization**

When there is a monopoly, high degree of monopoly power terms of trade are favorable.

**3. Import Quota:-**

This means quantitative restriction. It leads to unfavorable terms of trade to the exporting countries.

**4. Devaluation**

This is lowering of country currency which lead export to be cheaper and import expensive hence unfavorable.

**5. Tariffs (import duty):-**

Increase in import duty leads to increases in import prices, leading to unfavorable terms of trade

**Causes of unfavorable terms of trade:-**

1. Increase in supply of exports which lead to decrease in their prices.
2. Decrease in demand for a countries export leading to fall in export price.
3. An increase in demand for import leading to an increase in their price.
4. Political instability affecting production.

**Factors leading to favorable terms of trade:-**

1. Decrease in supply of export which leads to increase in their prices.
2. Increase in demand for a countries export leading to rise in export price.
3. A decrease in demand for import lead to decrease in their prices

**Reasons for deteriorating terms of trade in leads:-**

**Qns: Discuss why terms of trade in lack are mostly unfavorable:-**

1. Discovering of synthetic materials in developed countries this includes nylon and plastic bags.
2. Introduction of import substitution industry in developed countries. Developed countries have build industries which produce the originally imported products.
3. Diminishing returns.

In LDC's most countries are ago based countries and due to limitation of land and increase in population affect etc.

4. Most of products produce in LDC's have low price elasticity and Manufactured products have high price elasticity

5. Introduction of raw material saving technology which reduces the demand of raw material by developed country e.g. recycling
6. Monopoly power of primary products like petroleum used in production. Most of the products are found in developed countries.
7. Technology level In LDC's

In LDC's have low technical progress.

**Qn. Discuss the possible solution for deteriorating terms of trade in LDC's:-**

**The following are some of the solution:-**

1. Controlling import by reducing imports, using import substitution method, recycling.
2. Using economic integration where countries come together and remove barriers such barriers include tariffs.
3. Use of export promotion

Export promotion increases the demand of export leading to increase in price.

4. Improvement in technology

Using of modernized machines.

5. Control population

Increase in population leads to increase in demand and vice versa.

6. Investment in manufacturing industry which produce goods with high elasticity.
7. Discovery of new resources.

### **BALANCE OF TRADE (B.O.T)**

Is the difference between the value of the countries visible export and visible imports:-

- Visible trade involves buying and selling physical goods.
- Invisible trade involves buying and selling services

**Balance of trade can either be favorable or unfavorable:-**

- **Favorable balance of trade** occurs when the value of export exceed the value of import.
- **Unfavorable balance of trade** occur when import value exceed export value.

$B.O.T = \text{Total value of (X)} - \text{Total value of (M)}$ .



## **BALANCE OF PAYMENT (BOP):-**

Is an accounting statement that shows the difference between in flow (receipts) and outflow (payment) of foreign currency within a specific time.

Balance of payment is divided into the following account:-

### **1. CURRENT ACCOUNT**

This is an account that has the following accounts:-

1. Goods and services account.
2. Unilateral accounts which deals with grants and loans

The following is shown in the current account:-

1. The difference between visible export and visible import
2. The difference between invisible export and invisible import.

$(\text{Visible export} - \text{Visible import}) + (\text{Invisible export} - \text{invisible import}) = \text{Net current balance.}$

The net balance can either show surplus or deficit. Deficit means there is more out payment than in payment.

### **1. CAPITAL ACCOUNT:-**

Net long term capital in flow

Net short term capital inflow

Net short term government capital inflow

Net long term government capital inflow

If the sum above is positive there is a surplus and if negative there is deficit.

### **2. FINANCIAL ACCOUNT**

This accounts record international monetary flows such as investment in business, real estates and in stock exchange.

#### **Disequilibrium in balance of payment:-**

Occurs when total payments to abroad exceed total receipts from abroad.

**The following are its major causes:-**

1. Increase in demand for imports

The more you import the more money you pay:-

2. Decrease in demand of export product.
3. Devaluation policy which makes export expensive and import cheaper.
4. Unfavorable terms of trade
5. Poor climatic condition particularly agricultural based countries.
6. Trade sanction
7. Inadequate capital goods leading to low level production.

#### **Methods of controlling disequilibrium B.O.T:-**

1. Reducing importation through trade restriction.
2. Promote export
3. Devaluation of currency combine with import restriction
4. Proper utilization of resources
5. Seek for more financial assistance
6. Restrict or reduce capital outflow

#### **Qn: Suggest reasons for persistent balance of payment deficit:-**

### **EXCHANGE RATES**

Is the price of a country's currency expressed in terms of another country's currency.

#### **TYPES OF EXCHANGE RATE**

##### **1. Floating / free exchange rate**

This is an exchange rate that is determined by market forces. i.e. demand and supply.

- The forces of demand and supply make exchange rate flow upward and downward.

#### **ADVANTAGES**

1. There is no government intervention
2. It helps in managing the deficit in balance of payment.
3. It helps indicate the strength of the currency.
4. It makes the price of domestic currency against foreign free and fair.
5. It reduces competitive exchange rate depreciation among countries.

#### **DISADVANTAGES**

1. It causes uncertainty to businessmen
2. In some cases there is government intervention leading to no free exchange rate.
3. It leads to inflation, particularly imported inflation.
4. Leads to misallocation of resources
5. It has speculative effect to businessmen

##### **2. Fixed exchange rate:-**

- It is a system where by countries fix their values of currency in terms of other countries currency or
- Its an exchange rate which government set and maintain rate of exchange through central bank.

### **ADVANTAGES**

1. It helps to remove uncertainties
2. It discourages speculation among businessmen
3. It reduces inflation especially imported inflation
4. It is easier to predict future prices
5. It enable economic integration to take place among different countries
6. It enables the government to plan and implement its responsibility easily

### **DISADVANTAGES**

1. It imposes a burden to the government, central bank in controlling the exchange rate.
2. It affects the balance of payment equilibrium by:-
  1. overvaluing the currency
  2. undervaluing the currency
3. It may lead to inflation
4. It makes it difficult to control a deficit in balance of payment.

### **3. MULTIPLE EXCHANGE RATES**

Is an exchange rate system where a given foreign currency is purchased at different rate (price) for a local currency

The exchange rate depends on government interior in controlling importation for example basic needs are given at lower exchange rate while luxury goods are given a higher exchange rate.

### **PEGGED EXCHANGE RATE:**

Is a system where the price of particular / domestic currency is stick/ fixed in relation to a given foreign currency, for example TSH and dollar where all the prices of goods and services in Tanzania are determined by dollar.

### **INTERNATIONAL INSTITUTIONS USED IN INTERNATIONAL TRADE**

1. **I.M.F:-** International Monetary Fund
2. **I.B.R.D:** International Bank for Reconstruction and Development (World Bank)
3. **I.F.C:-** International Finance for Cooperation

# ECONOMIC INTEGRATION AND COOPERATION

## CONCEPT OF ECONOMIC INTEGRATION:

- Economic integration is the union of countries which has common objectives and agreed to cooperate in order to create collective bargaining so as to enjoy social, political and economic advantages.
- Economic integration is the union of countries/ group of countries which work together voluntarily to meet their common economic social and cultural needs through jointly owned and democratically controlled enterprises and individual activities.

**Examples of economic integration are East African community (EAC), European Union (EU), Southern African Development Cooperation (SADC) etc.**

## FORMS OR TYPES OF ECONOMIC INTEGRATION

Economic integration passes through different stages of development before reaching at the highest/ final stage as follows:-

1. Preferential trade area (PTA)
2. Free trade area/ free trade
3. Custom union
4. Common market
5. Economic union.

### 1. PREFERENTIAL TRADE AREA (PTA)

This refers to the initial stage of economic integration where by member countries agreed to make gradual reductions of trade barriers (tariffs) among member countries as the way of reducing international cost of trading and enjoying international benefits. Example PTA OF COMESA

### 2. FREE TRADE

This is the second stage of economic integration where by member countries agreed to eliminate all trade barriers against movement of goods and services from one country to other countries. In the free trade area member countries agreed to create free movement of goods and services from one country to another but each country forms own barriers and tariffs against non members.

### 3. CUSTOM UNION

This is the stage of economic integration which involves elimination of trade barriers within a region to create free movement of goods and services (free trade) and member countries form common tariffs to non members.

### 4. COMMON MARKET

This is the stage of common integration where by member countries agreed to create free movement of goods and services (free trade) and form common trade barriers against non- members and free movement of factors of production such as labour, capital, entrepreneurs within a region/ member countries under common market people are free to work, to invest and own land within a member country. Example of common market is East African

Common Market.

## 5. ECONOMIC UNION

This is the highest form of economic integration where by member countries agreed to create free movement of goods and services, free movement of factors of production such as land labor, capital and entrepreneurs, formation of common tariffs against non members further more countries agreed to create common policies such as fiscal policies, monetary policy, trade policy and other economic policies within a region. While well developed economic union use same currency in transaction. Example of economic union is European Union which uses euro currency.

### THE CONDITIONS NECESSARY FOR SUCCESSFULLY ECONOMIC INTEGRATION

**Successfully economic integration is the one which achieve pre determined objectives within a specified period of time /at given on desired resources (cost). The following are necessary factors for successful formation of economic integration.**

1. Countries should be geographically close. This will facilitate transactions and reducing cost of transaction and interaction / meeting.
2. Production of different commodities facilitate people to sale what they produce and buy what they fail to produce and gain from Trade.
3. The use of different currencies of low variations in terms of value or similar currency. This will encourage trade and gain in international trade.
4. Political stability among member. This will encourage production activities and international transactions among member countries.
5. Countries should have equal level of development. Economic integration of developing countries should formed by countries with equal level of development (developing countries) while developed countries should create integration of developed countries but not mixture of developed and developing countries. This will create equal trade and equal gain.
6. Countries should have similar goals and determination. This will facilitate member countries to form common strategies and policies of achieving objectives.
7. Availability of improved economic infrastructure i.e. transports and communication system because improved infrastructure facilitate movement of commodities and people from one country to another.
8. Similar political and economic ideology i.e. countries should be in same economic system that use common policies and strategies of achieving regional objectives

### GENERAL ADVANTAGES/ IMPORTANCE OF AN ECONOMIC INTEGRATION

All economic integration may have the following benefits in general.

1. To increase the volume/extent of market and volume of trade. Economic integration provides a chance for country to exchange within and outside countries boundaries this will increase gain in trade.
2. Increase in collective bargaining and rise in price of an exported commodities. Before economic integration each country bargain individual but after formation of economic integration countries will bargain together for their benefit against non members
3. Improvement in social and economic infrastructure. Economic integration has a tendency of creating common policies of improving social and economic infrastructures such as roads, railway, school, hospital, air way.

4. Improvement of technology within member countries. Economic integration allows free interaction and movement of people and goods from one country to another also they formulate common strategies of technological development hence all this help to transfer and development of technology.
5. Increase in level of employment. Since economic integration allow free movement from one country to another, Free investment in any country and free to work anywhere within a region, this will increase employment of the factor of production such as land, labor and capital.
6. Maintenance of peace and security (political stability) within a region it occurs because member countries agreed and formulate common strategies and policies of maintaining peace and securities within member countries.
7. Increase in supply and production of goods and services within a member countries due to the investment and free movement of goods and services this will increase consumers utility and choice.
8. Trade creation. This is the process of purchasing commodities at low price within a region compare to the cost of purchasing from non member.
9. Economic integration stimulate competition among firms of member countries competition increase due to the free interaction among people and commodities that lead to the increase in efficiency and qualities of commodity exchanged.
10. Economic integration promote social political and economic cooperation this will increase benefit to member countries.

## **DISADVANTAGES OF ECONOMIC INTEGRATION**

Most of economic integration formed by developed countries has the following disadvantages in general.

1. Increase in import which lead to unfavorable balance of payment, this occurs to the countries which has weak economic base which increase demand for import.
2. Excessive competition among countries that leads to the decline in an infant domestic industries and unemployment problem to affected countries.
3. Loss / decline in government revenue since economic integration involve reduction and elimination of tariffs (tax) therefore it reduce government revenue collected from tax.
4. Increase in importation of low quality and harmful products, this cause country to be a dumping area.
5. Economic integration may cause occurrence of imported inflation, this inflation may occur due to the importation of commodities from the countries which are already affected by inflation.

6. Economic integration may cause unequal gain, this occurs due to the unequal industrial development and business of one direction.
7. Economic integration may cause cultural destruction. This occurs due to the interactions of people of different culture from different countries.
8. Trade diversion. This is the situation which occurs when people/ country purchase commodities at higher cost/ price within member countries due to geographical and organization barriers compare to the cost of purchasing commodities from non members.

#### **GENERAL PROBLEM FACING MOST OF ECONOMIC INTEGRATION FORMED BY LDC'S**

**Most of economic integration in developing countries likes EAC, SADC, and ECO WAS, face the following problems:**

1. Shortage of fund for running economic integration and economic activities within the region such as investment, this cause failure of most of economic integration to achieve predetermined goals.
2. Political instability. Political conflicts which arise within the region or outside the region / neighbor countries affect social and economic activities of economic integration.
3. Low development of technology. This hinders industrial development and limit efficiency in investment and production activities within the region.
4. Low development of economic infrastructure. In most developing countries there are poor roads, railways and communication networks which limit production and movement of people, goods and services from one place to another.
5. Lack of political commitment and bad leadership. Most of countries which form economic integration in LDC'S has bad governance and they are not committed for the development of integration but they are committed for individual country's benefits this limits achievement of common objectives.
6. Low level of education and skills among people. Most of people in developing countries are not educated and skilled enough to conduct social and economic activities, this limit investment and other economic activities.
7. The storage of market and price fluctuation in the market since most countries produce agricultural products with similar type this limit availability of market because every country produce such kind of commodities and price of agricultural product fluctuate more that cause loss
8. Rapid population growth, this increase pressures on resources utilization, occurrence of environmental problems, communicable diseases, labor unemployment and other social economical effects.

#### **REGIONAL ECONOMIC INTEGRATION (INTEGRATION BLOCKS)**

Most of state worldwide decided to establish and join in the economic grouping for the purpose of enhancing economic cooperation among the member countries, some of grouping have risen and fallen while a number of them survive.

The regional economic integration discussed in these subtopics is:

1. **East African community (EAC)**
2. **Southern African development community (SADC)**
3. **The common market for eastern and central African (COMESA)**
4. **European economic community (EEC/EU)**
5. **Economic Community of East African States (ECOWAS)**

#### **EAST AFRICAN COMMUNITY (EAC)**

This is the cooperation/ union of east African countries which has common objectives and self commitment to increase/ Deeping cooperation among member of integration so as to enjoy mutual advantages socially, politically and economically.

**East African community is the regional intergovernmental organization of Kenya, Tanzania, Uganda, Rwanda and Burundi.**

East African community just like other economic integration aimed at increasing collective bargaining in economic, social and political issue and formation of common strategies and polices of achieving common objectives and benefits

## **BACK GROUND/ HISTORY OF EAST AFRICAN COMMUNITY**

The east African community (EAC) is the community with long history, the genesis of east African community can be traced back to 1923 when east African governor's conference formed, and then on 1<sup>st</sup> January 1948 the east African high commission replaced, the east African governor's conference. Then after Tanganyika independent on 9th December 1961. The east African service organization (EACSO) was established. These create a foundation of former and current / new east African community.

## **FORMER EAST AFRICAN COMMUNITY**

This was economic cooperation of east African countries namely Tanzania, Kenya and Uganda. The reality of establishing former east African community signed by president of three east African countries on 6<sup>th</sup> June 1967 in Kampala Uganda. But communities come into existence effectively on 1<sup>st</sup> December 1967 as a replacement of eastern African service organization and effective formation of east African common market(EACM), from that day most of function performed by EACSO and employees were taken by EAC. Also Arusha became headquarter of the EAC.

The former east African community were aimed at promoting free trade of commodities, to provide common services, creating free movement of people, increase in extent of market to deep cooperation, making common research and development.

## **FACTORS/ REASONS FOR DECLINE OF FORMER EAST AFRICAN COMMUNITY**

**The collapse of former east African community is due to the following reasons:**

1. Difference in political and economic ideologies among member countries for example Tanzania was socialist country while Kenya was capitalist country.
2. Political misunderstanding/ conflict between Tanzania and Uganda, this cause late MWL JK NYERERE and IDD AMIN could not meet when east African community meet.
3. Failure of east African development bank to meet expected objectives.
4. Donors influence and the problem of neo colonialism. Some of member countries serve colonial interest that goes against interest of east African community.
5. Lack of clear and agreed pattern of industrial specification and each country work for their own goals and plans that cause unequal gain in east African community.

## **THE NEW EAST AFRICAN COMMUNITY**

The new East African community is the economic integration of east African countries aimed at creating deep cooperation among East African countries economically, socially and politically. The formation of new East African



community started in early 1980's when member of former east African community meet for division of asset and liabilities of former east African community but the treaty for establishing East African community signed on 30<sup>th</sup> November 1999 but new East African community started to work effectively on 1<sup>st</sup> July 2000.

East African community has five member countries namely Tanzania, Kenya, Uganda, Burundi and Rwanda it has head quarter Arusha, Tanzania.

### **OBJECTIVES OF NEW EAST AFRICAN COMMUNITY**

The currently formed East African community has the following objectives.

1. To create free movement of goods and factors of production within a member state by making gradual and reduction of the tariffs and other form of barriers (common market)
2. To strengthen and develop policies and programs aimed at winding and Deeping cooperation among partners in political, economic and social matters
3. To promote gender and enhancing the rule of woman economical, social, political and technological issue development
4. To promote sustainable utilization of resources and balance growth in development of partner state
5. To enhance and promote equitable economic development within the partner state and raise standard of living and quality of people life in member countries i.e. people centered development.
6. TO promote peaces security and stability within and good neighborhood among member countries
7. Enhancement and strengthen of partnership with the private sector and civil societies in order to achieve social economic development.

### **THE AREAS OF COOPERATION IN THE NEW EAST AFRICAN COMMUNITY/ COOPERATION**

The current formed East African east cooperation covering the integration and cooperation in the following areas.

#### **1. Cooperation in trade and development.**

East African community agreed to create trade militarization where by member countries should reduce up to elimination of trade barrier to the custom union and common market in order to create free movement of goods and factors of production.

#### **2. Cooperation in social and economic infrastructure**

They agreed to harmonies and adopt policies and laws of improving social and economic infrastructure and joint use facilities in transport and communication for joint development

#### **3. Monetary and fiscal cooperation (financial cooperation)**

Member countries agreed to establish monetary and fiscal union means economic policies and elimination of obstacle against financial investment within member state like banking and convertibility of currencies and other strategies of achieving monetary union i.e. the use of one east African currency.

#### **4. Cooperation in human resources, science and technological advancement.**

Under this union member countries create union and cooperation in education, training, and jointly establishment of common policies and strategies of human resources mobilization, science and technology development.

#### **5. Cooperation in agriculture and food security.**

With the aim of adopting scheme of rationalization of agriculture production in order to promote complementary and specialization in order to increase food supply and having surplus food for security for food shortage.

#### **6. Cooperation in tourism and wildlife management**

Member countries agreed to have common, collective and coordinated policies and approaches of promoting and marketing quality tourism, conservation and utilization of wildlife and tourist center.

1. cooperation in environment and natural resources management
2. cooperation in investment and industrial development other are legal and justice, role of woman political matters and private sector

**Note: the merits demerits and problems facing east African community are similar to those discussed in general in the previous page.**

### **THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY (SADC)**

The Southern African Development Community (SADC) is an association of Southern Central and some of Eastern African Countries agreed to deep cooperation in all matters relating with development.

SADC formed from experience of political cooperation gained by front line state such as Angola, Botswana, Lesotho, Mozambique, Tanzania, Zambia and Zimbabwe in supporting independence movements. SADC was formed to replace the former Southern African Coordination Conference (SADC) formed 1980 which aimed at helping Southern African countries to become developed and self reliant and reduces dependence on South African and other strong nations.

SADC come into existence on August 1992 with eleven member countries namely Angola, Botswana, Lesotho, Zambia and united Republic of South African.

#### **OBJECTIVES OF SADC**

1. To achieve a genuine and equitable economic growth and development, alleviate poverty, enhance standard of living and quality of people's life of member state
2. To evolve common political value, system and institutions
3. To promote and defend peace and security in order to maintain political stability within a region.
4. To promote and maximize productive employment and utilization of resources and effective environmental protection
5. TO promote international cooperation and achieving a complementary between national and regional strategies policies and programmers

The ultimate objective of SADC, the community is therefore to build a regional cooperation in which there will be a high degree of harmonization and rationalism to enable the pooling of resources to achieve collective self reliance in order to improve the living standard of the people of the region.

#### **PROBLEMS FACING SADC**

However, under new restructuring exercise it has become clear that there are a number of problems that inhibit the effect and performance inefficient of the current structure includes:

1. Inadequate provision of resources and staffing by member state which has lead to inadequate distribution of responsibility and obligations
2. Different management and administrative procedures and rules, varying standard qualifications, and performance criteria for staff involved in the management of the regional programmer.
3. Rapid increase of sector and therefore create problem of priorities and activities dependent on limited resources which has lead to increase in an association costs.
4. Under the current structure and circumstances the secretariat has been unable to execute its mandate as provided for in the treaty especially that of under taking strategic planning and management
5. Lack of an institutional framework in which ministers responsible for foreign affairs in the SADC region could discuss and adopt common positions on matter pertaining to the organization in various international forces.
6. Difference in level of development, this reduces cooperation, equal development in trade and lead to unequal gain.
7. SADC member give priority to their own national interest compare to the regional interest
8. Political instabilities existing within a member countries like Zimbabwe and Congo etc.

### **THE COMMON MARKET FOR EASTERN AND SOUTHERN AFRICA (COMESA)**

COMESA is the Southern and Eastern African Common Market formed by countries from Southern and East part of African for the aim of creating free movement of goods services and factors of production from one country to another

COMESA started to work on December 1994 as a replacement of former PTA, COMESA has the following members; Angola, Tanzania, Malawi, Lesotho, Mozambique, Zambia, Mauritius, Kenya, Sudan, Comoros, Ethiopia etc.

### **THE GENESIS/ ORIGIN OF COMESA**

The history of COMESA started 21<sup>st</sup> December 1981 when treaty of establishing preferential trade area (PTA) signed to form an organization of free independent sovereign states which have agreed to cooperate in developing their natural and human resources for the good of all people in member state. Then on 6<sup>th</sup> November 1993 member of COMESA signed treaty of establishing COMESA which then start to work 1994.

**COMESA'S** economic history and background. Its main focus on the formation of a large economic and trading unit

That is capable of overcoming some of barriers that are faced by the individual member state.

**COMESA'S current strategy can this be summed up in phase economic prosperity through integration with 21<sup>st</sup> members state.**

The COMESA states in implementing a free trade area are well on their way to achieving their large of removing all internal and external barriers and trade tariffs, an exercise which is to be completed by the year 2000. Within 4 years after that COMESA will have all third party trade and will have considerably simplified all procedures.

### **OBJECTIVES OF COMESA**

-Trade liberalization and customs cooperation including the introduction of unified computerized customs networks access a region.

- Improving administration of transport and communication to easy movements of goods, services and people between the countries.
- Creating an enabling environment and legal framework which will lead or encourage the growth of private sectors, the establishment of secure investments environment and adopting common set of standards
- The harmonization of macro economic and monetary policies throughout the region.
- To increase agricultural development/productivity and food security.
- Greater industrial productivity and competitiveness among member state.
- To stimulate strong economic base for a member as steps toward independence of a region.

### **TANZANIA'S WITHDRAWAL FROM COMESA**

Tanzania officially pulled out of COMESA on September 2000, where by Tanzania decision made known to all other members and stakeholder that Tanzania is no longer trade friend on COMESA.

However according to URT Tanzania would continue retaining its position in two region blocks namely PTA bank and reinsurance company (ZEP-RE) simply because this institutions cover even non COMESA member.

#### **The reasons for Tanzania withdrawal from COMESA are followings;**

- Failure to realize its goals that is strengthening, developing and positively maintaining social-economic relationship
- Lack of seriousness among members in implementing goals.
- Continuous reduction of tariffs which reduce government revenue.
- Protection of infant domestic production industries and Anti-dumping due to free entrance of cheap and harmful products.
- The problem of membership with other unions i.e. SADC, EAC.

### **THE EUROPEAN ECONOMIC COMMUNITY EUROPEAN UNION**

European economic community/ European union is an economic integration formed by European countries that agreed to make gradual reduction of tariffs and other barriers and adopting common policies of increasing economic, social and political benefits to member countries.

The European union established in 1957 where by six European countries signed Rome treaty, This form European Economic Community(EEC) popularly known as European Common Market, the six countries signed the treaty include France, Italy, Belgium, the federal republic of Germany, Holland and Luxemburg. It actually comes into existence effectively in January 1958

From date of establishment this integration start to expand and cooperation has gradually been expanded, tariffs and other barriers are gradually re-educated eliminated new policies and strategies formulated while it adapted to new challenges according to what of majority Europeans agreed. Currently European Union has fifteen member state namely France, Italy, Holland, Belgium, West German, Luxemburg, England, Greece, Portugal, Spain, Ireland, Denmark, Australia, Sweden, Finland.

Although European Economic Community started as an economic zone/ community of European countries ( common markets) it adopt gradual improvement up to European union currently and regarded as a unique organization and more than any other international organization it has many committed member and characterized by democratic decision that help to reach at the highest level of economic integration known as economic union by passing through **common market, custom union, and monetary union** where by member countries agreed to use European currency as a medium of exchange also they formulated a common agricultural policies (CAP), European development bank and other economic and social development policies

### OBJECTIVES OF THE EUROPEAN UNION (EU)

1. To harmonies the common policies for improving the living standard of the people in member countries.
2. To encourage and ensure coordination and cooperation in trade in other economic activities.
3. To increase industrial and agricultural development and increase in agricultural output, this done by establishing common agricultural and industrial development policies
4. To facilitate free flow of manpower within a member state.
5. To ensure national business policies do not harm the other member such as tariffs and other barriers of trade.
6. To faster development of infrastructures by establishing common policies of improving transport and communication system such as roads and inland water transport.

### TANZANIA AND EUROPEAN UNION/ COMMON LINK BETWEEN EUROPEAN UNION DEVELOPING COUNTRIES (LOME CONVENTION)

Tanzania and some of developing countries has a close relation with the European Union through the lame convention.

The Lome convention is series of agreement in trade and economic cooperation between European Union and countries from African pacific and Caribbean (ACPS). Lame convention come into existence in 1975 when EU and 46 ACP'S countries meet and sign first contract of Lome convention affected on 1979 with emphasize on agricultural, energy and other natural resources development. 3<sup>rd</sup> agreement was signed on 1<sup>st</sup> April 1985 with emphasize on former agreement.

The 4<sup>th</sup> lome convention signed in 1990 in Kampala Uganda with emphasize on the increased cooperation between EU and ACP in trade, industries, agricultural.

Also fourth Lome convention emphasis on fighting against **HIV/AIDS**. However countries are still rigid to allow free trade especially in textiles. Lome convention made ACP countries a right of association status as an indirect member of EU. Through cooperation the ACP states benefited in a field of finance trade and industries.

### BASIC PROVISIONS OF THE LOME CONVECTION

Lome conventions involve agreement and cooperation in the following ground.

1. Trade cooperation and development
2. protection of ACP'S industries
3. stabilization of export earnings (STABEX)
4. ACP'S country has chance and control over the EU development fund than formerly
5. A free decision of ACP'S country when they need to pull out of lame convection if the agreement is no longer satisfactory

## ADVANTAGES OF THE LOME CONVECTION

The ACP'S countries including Tanzania may enjoy the following advantages

1. The ACP's state can earn more stable income from their export of raw materials. They are now less affected to price fluctuation i.e. stabilization of export earnings.
2. Increase in assistance/access of grants and aids from European union i.e. EU development banks and funds
3. It does not promotes new colonialism because one of agreement and promise of EU is to fight against new colonialism
4. Improvement of ACP'S industries, Lome convention assist development of ACP'S industries due to the promise of imposing tariffs against EU products and getting g technical assistance from EU.

## PROBLEMS/CHALLENGES FACING EUROPEAN UNION.

1. The problem of labor supply due to agreeing population in some countries as a result of strict population control policies.
2. Economic disparity among countries; thus limit decision power and gain in international trade.
3. Disagreement among countries member of EU are not agreed in some of common policies and implementation of policies for example some of countries like Britain Portuguese refers to use euro currency while some reflect implementation of agricultural and other policies.
4. The world economic crises, this imposes problem/ challenge in fighting with the result of reason or depression and other country fail to finance their requirement.
5. The problem of over production/ over supply which lead to the shortage of markets in European countries.
6. Unemployment problem, despite of effort and different strategies still there is unemployment problem
7. Disunity among European countries. This limit the implementation of some policies.

**Note:** The regional economic integration of developing countries like EAC, SADC, COMESA and ECOWAS has similar advantages and disadvantages to member countries and they face similar challenges (problems) as discussed in general in an introduction part of this topic.

## ECONOMIC COOPERATION

**Economic cooperation** is the intergovernmental organization which involves many nations that provide platforms to discuss ways of improving development and promote trade and investment opportunities together with the creation of socio economic sustained within a member state.

**Regional economic cooperation** is an association of cooperation of countries with objectives of creating cooperation in different field socially, economically and politically most of economic cooperation has no deep union and interaction compare to the economic integration.

**Regional/ international institution** and bodies that unite all or most countries in the world to fulfill certain various functions concerned with international economic relations. These functions may include coordinating common economic policies or maintaining some international economic links.

International economic cooperation does not pre-suppose deep economic and political relationship between countries and their national economic. International organization which characterized international economic cooperation include UN'S specialized agencies and forms such as **WTO, UNCTAD, IBRD, IMF** and so on

It follows therefore that international economic integration and international economic organization/ cooperation are forms of cooperation they share same advantages that may be obtained through their forums.

However international economic – economic cooperation is more loose cooperation than international economic integration it does not have the disadvantage of the later such as the distribution cost and benefits among member countries and some forms of political and economic sacrifice being necessary for integration but not necessary for cooperation.

### **INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (IBRD)/ WORLD BANK (WB)**

The international bank for reconstruction and development (IBRD) is an international financial institution which offers loans to middle income developing countries, influencing economic activities and graduating poverty. IBRD provides commercial grade or concessional financial to sovereign state to fund project, that seek to improve transportation and infrastructure, education, domestic policy, environment consciousness, energy, investment, healthcare, access to food and portable water and improved sanitation.

IBRD/ WB established 1944 following a Bretton Woods conference but began to work effectively 1946; IBRD has over 181 members (188 currently), it owned and governed by member state but has own executive leadership and staffs.

#### **OBJECTIVES/ FUNCTIONS OF IBRD/WB**

1. To reduce poverty in middle income and poor countries by promoting sustainable development through provision of loans
2. To provide analytical and advisory services by providing experts of doing that
3. To promote transfer and development of technology especially from developed to developing countries
4. To finance development project such as infrastructures, water, agricultural project, environmental protection etc.
5. Provision of research consultancy and training i.e. World Bank provides platform for research, consultancy and conduct training programs on development issue.
6. To support and initiate corruption movement in order to eradicate / combat corruption.
7. To promote long term balanced growth of internal trade and maintenance of equilibrium in the balance of payment

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## **ECONOMIC PLANNING**

### **Introduction**

- **Economic plan** is the set of goals/objectives that a person/government intends to achieve within a specified period.
- **Economic planning** is the process of organizing available resources of a country or individual for the purpose of fulfilling certain objectives/ pre determined objectives.

**Planning can be done by government producers or consumers in the following ways.**



- **To the government**

Planning is the conscious or deliberate government efforts/ action to influence direct and control economic variables. Economic variables are those economic phenomenon which affects economic activities or cause economic changes example of these variables are **investment, inflation, population changes etc.**

- **Planning to producer**

Is the process of decision on how to use/ allocate available economic resources to produce goods and services, it is concerned with the decision of how to produce, when to produce and for whom to produce. So as to satisfy human want while maximizing profit if producer aimed at maximizing profit.

- **Planning to consumer**

Is the process of making decision on how to use available resources (income) in consuming /purchasing goods and services in order to maximize utility /human wants?

## **PLANNING IN ECONOMIC SYSTEMS**

**Economic planning differs depending on economic system under which economic planning performed mostly differs on objectives/goals and who make that plans in the following ways.**

- **PLANNING IN CAPITALIST ECONOMIC SYSTEM**

Under capitalist economic system no central planning, planning are done by individual firm/ company/ person through price mechanism. Those means price mechanism influence allocation of economic resources and influence the process of making decision of what to produce to whom to produce where to produce etc. under capitalist economic central government play the role of providing conducive environment or indication to the private sector but not ready to made decisions. Instead concerning with protection of order and economy at large most of plan in capitalist is partial plans.

- **PLANNING IN SOCIALIST ECONOMIC SYSTEM**

In socialist countries there is central planning that is government concerned with formulation and implementations of various economic planning on behalf of its citizens. Most of plans in socialist is comprehensive in nature they cover the entire nation because the aim of plains is to improve living standard of all people or equitable development.

- **PLANNING IN MIXED ECONOMIC SYSTEM**

Under mixed economic system there are both government plans and price mechanism. That means government plans allocation of resources in some area while individuals also make decision /plans for their firms. Under this system government plans for improvement of an economy and creating economic stability while private company/ firm plans for their own benefits especially for profits maximization.

## **CLASSIFICATION OF PLANNING**

### **A/ Classification by Coverage**

#### **1. Comprehensive Planning**



This is the type of planning in which all sector in an economy are taken into consideration and conducted by central government in order to meet the entire economy. This planning takes into amount sectoral priority and interdependence. Such plans cover both private and public sector. Example of this plan is annual national budget.

## **2. Partial Planning**

The alternatively known as (secretarial planning). This is the types of planning that cover only one sector in an economy that means government plans to develop and influence only one sector in an economy. Example of such planning is basic industrialization plan/ program of 1995 – 2000 this is the plan in which government intends to industrial sector in an economy over 25 years.

## **B/ Classification of Planning According To Time Taken To Accomplish Intended Objectives**

### **1. Short-Term Planning**

This is the type of planning that cover I take a period up to 2 years for the objectives or intended goals to be achieved for example annual budget which cover 1years of implementation.

### **2. Medium Term Planning**

This is the type of plans that take a period of 2 up to 7 years for the objectives to be achieved. For example villagelization of 1972.

### **3. Long Term Planning**

This is the type plans that take a duration of time or long term for objectives to s 20 years or beyond that period. Example of such plan is import substitution strategy of 1995- 2000.

## **C/ Other Classifications**

- **Centralized planning**

This is the type of government planning in which plans / objectives are formulated by the central government but implementation done by local government or societies. That means central government form plans then direct it to local government and society for implementation to achieve predetermined goals.

- **Decentralized Planning**

This also is the government plans formulated by local government but implemented by central government. That means local government formulate objectives/ goals and send off to central government in which central government direct and influence resources in order to implement such plans.

- **Indicative planning/ directive planning**

Is the type of economic planning in which central government prepare a plan of indicating all sectors /firms what and how to allocate resources and provide conducive environment on what to do. Indicative planning most occurs under capitalist economy in which government indicate private sectors what to do / how to make decisions and government are not concerned with ready maker decision instead provide conducive environment for private sector and order ruling its citizen.

- **Authoritarian planning**

This is the type of economic planning which is prepared by government and also implement the planning. Thus plans are more comprehensive, systematic, and rigid but more efficient

- **A democratic planning**

This is the type of planning which is prepared by expert body called planning authority outside the government. It is based on the system of free market economy.

## **THE OBJECTIVES OF ECONOMIC PLANNING**

**When government formulates economic planning there are several objectives, the government would like the country to achieve, these objectives may include the following:-**

1. To achieve a rapid economic growth and economic development
2. To achieve high level of employment in the country i.e. to reduce unemployment problem
3. Reduction of poverty and income inequality in an economy
4. To achieve price stability e.g. To solve inflation problem
5. To achieve favorable balance of payment situation in a country
6. To achieve diversified and self reliant economy etc.

## **BASIC IMPLICATION OF PLANNING/ THE PLANNING PROCESS**

**The planning supposed to be continuous process and the main stages / implications of economic planning are:-**

1. Formulation of objectives or goals to be achieved. That means planners should define what to be achieved
2. Plan formation. Thus involves setting up a plans or target and ways of achieving those objectives and priorities.
3. Mobilizing the financial and other resources required for the implementation execution of the plan.
4. Plan implementation this involves creating the necessary organizations for implementation and transforming plan into actual work.
5. Plan evaluation this involve assessing the progress which has been made and revision and improvement of plan.

## **CHARACTERISTICS OR PROPERTIES OF ECONOMIC PLANNING**

**Any economic plan should have the following features in common:**

1. **Plan objectives/ goals.** Planning should attempt to define goals/ objectives as they relate to future development of the economy.
2. **Plan policies and strategies.**

A development plan should set out strategies and policies this is the means by which objectives can be achieved which are normally translated into specific targets.

### **(c) Comprehensiveness.**

A development plan must cover the whole economy or sometime may identify sector in an economy (partial)

1. **A plan period.**

A good economic plan typically covers a specific period of time. Let say one year or 5 year for objectives to be accomplished that means short run or long run period.

**(e) A planning machinery.**

This is the number of ministries, institutions, firms or individuals even authority established for the purpose of formulating, execution and evaluation of the economic plan.

**(f) Internally consistent.**

The economic plans attempts to presents a centrally coordinated, internally consistent set of principle and policies chosen as optional means of implementing the strategy and objective.

**Note;** among all above characteristics of the successfully economic plans must have enough resources both human, financial and other resources.

### **DISADVANTAGES OF ECONOMIC PLANNING**

1. Planning sometimes may lead to misallocation of economic resources such as production allocation of resources in unproductive sector, allocation of resources/ services where they are not highly demanded mostly for political reasons.
2. Planning discourage competition between producers hence lead to inefficient in production and provision of services and production of low quality products.
3. Planning increase government expenditure/burden due to resources used in implementing economic planning.
4. Planning encourage bureaucracy in making decision hence delay to reach the intended objectives and decisions.
5. Some plans fail hence cause wastage of resources and time taken to prepare and implementing plans.
6. Economic planning increase public debts and economic dependents in LDC'S this because implementation of plans needs resources in which most of them borrowed or granted from external donors.

### **ADVANTAGES OF ECONOMIC PLANNING**

1. Planning ensure effectively and efficiently allocation and utilization of economic resources this means planning ensure resources are allocated in productive activities and avoid misuse of economic resources.
2. Planning ensure equitable distribution of wealth this means planning help to allocate/distribute resources equality to the societies in order to maintain income equity to avoid income inequality.
3. Economic planning ensures optimum utilization of scare economic resources so as to produce output as much as possible.
4. Planning used as a tool of maintaining economic stability in an economy that means used to reduce and eliminating economic instability / problems such as unemployment, price instability such as inflation , unfavorable balance of payment.
5. Planning is helpful tool for seeking foreign aids in an economy this done by preparing plans of the ways ends can be used and presenting them to donors.
6. Planning can be used to control negative externalizes that means negatives effects of productions such as pollutions and environmental degradation.
7. Planning also used in achieving and maintaining high rate of economic growth and economic development.
8. Economic planning eliminates the failure of price mechanisms by planning to provide the welfare goods and public goods which are not provided by price mechanism because they are profitable.
9. Planning also used as tool of controlling quality and standards of a goods and services produced with in a country and also help to wide consumer's choice.

## DEVELOPMENT PLANNING

A development plan is a wide range of document of the government formulated in order to achieve long-term objectives in which primary objectives is to improve economic development.

**Development plan mostly classified into three main levels**

1. Macro level planning
2. Secondary level planning
3. Tertiary level planning

### Macro level planning

This is government plan which take into consideration the whole economy i.e. all economic variables. In developing country these plan cover a time of about 4 to 5 and above years.

Macro planning involves Annual plans and perspective plan in which perspective plans cover a long period of time.

### Secondary level plans

These are those plans that do not cover the whole country they may cover either one sector or Region this includes

**Secretarial plan** - this is the detailed plan for a specific sector of an economy for example plans for improvement of agricultural sector.

**Regional plan** – this is economic plan which focus its intention to a particular region or area within a country.

### Tertiary level plans

This is the plans which deal with identification of possible projects informs of cost and benefit and their implementation so as to improve performance of that project.

Tertiary plans either natively called projects plans

## THE STRUCTURE OF PLANNING IN TANZANIA

The structure of planning in Tanzania is two ways in the sense that, the economic plans are either initiated or formulated at the top by the government authorities and routed downwards for implementation with or without modification (centralized planning)

In the other hands other economic plans are initiated originate from the bottom and they are routed upwards for implementation (decentralized planning). All these plans are well coordinated and integrated and prepared for the whole economy.

At the present the planning process are under the ministry of planning and once planning have been worked out by the planning expert of the government, they need to be discussed and get approved by parliament which then endorse the resources which are necessary for the implementation of the plan. And during the course of

implementation the economic plan are evaluated constantly so as to assess its performance in order to amend necessary things for the aim of achieving the desired goals or objectives.

## THE PHASES OF ECONOMIC PLANNING IN TANZANIA

Since independence, Tanzania has passed through two main phases of economic planning

1. **Phase I**
2. **Phase II**

### PHASE I: ECONOMIC PLANS

The first phase comprise of all the economic plans from 1961 to early 1980's these plans were emphasis on 'equity' as were guided by the Arusha declaration

The phase I economic plan were aimed at fighting the main three things, illiteracy, disease and poverty.

Since Arusha declaration aimed at converting Tanzania into socialist and self reliant country hence various measure were taken to ensure all major means of production are owned by the government. Therefore consisted of the 1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup> five years development plans. In general these plans were aimed at rising per capital income so as to improve living standard, man power development, rising life expectancy so as to create self reliant.

### PHASE II: ECONOMIC DEVELOPMENT PLANS

These plans cover all plans that take place between 1980's to present, the phase II economic plans emphasize efficient of the government and performance of the economy. The phase two economic plans are in hand and in guidance of international done such as **IMF and World Bank**. The phase II economic survival programmer (NSSP) structural adjustment programmer (SAP'S) etc.

## HANDICAPS / HINDRANCES TO SUCCESSFUL PLANNING IN LDC'S LIKE TANZANIA

1. Insufficient knowledge/ lack of skilled planners. Most of personnel used in planning have no sufficient knowledge and skills in running and planning.
2. Presence of large private sectors in an economy. Government has no influence over private sector/ the large one and this sector has a tendency of running their activities against implementation of government plan.
3. Lack / inefficient planning machinery. The authorities used in formulating a plan are weak and fail to coordinate plans and implementation of that plan.
4. Lack of reliable information. In order plans to succeed needs information but there is no reliable statistical information and this lead to failure of most of plans because data fail to tell what happening in economy now so as to forecast what may happen in future.
5. Political instability and unstable administration. Political instability such as wars, and other conflicts and change in regimes while are at times accompanied by changes in goals and objectives hence make implementation and completion of government plans very difficult.
6. Dependence of aid from foreign donors. Most of plans in LCD's are financed by external donors hence the grants or resources received out of the time and may associate with conditions which are against our plan hence lead to failure of the plans.
7. Lack of specific and workable policies and poor coordination among the planners also cause failure of most the government plans.
8. Weak government participation and political will, thus also cause a failure of government plans.

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# STRUCTURE OF TANZANIA ECONOMY

## INTRODUCTION

The economic structure of Tanzania is the topic/ concept which explain and analyze economic aspects which form Tanzania economy and features of Tanzania economy.

The structure of Tanzania economy deal with analyzing economic sector which form Tanzania economy and an ownership system available in Tanzania basing on characteristics, contributions, problems and solutions to the problems facing economic components/ sector as the way of creating sound economic situation.

## COMPONENTS/ PATTERNS OF TANZANIA ECONOMY

The structure of Tanzania economy divided into two main patterns/ components. These are

1. sectoral pattern
2. ownership pattern

## SECTORAL PATTERN

This is the pattern aspect of Tanzania economy which analyze economic sector in Tanzania in terms of contribution, problem and solutions of the problems facing economic sector. All economic sectors in Tanzania economy are divided grouped into three (3) sectors.

1. **Primary sector**
2. **Secondary sector**
3. **Tertiary sector**

## PRIMARY SECTOR

This is an economic sector which deals with production of goods from origin or sources. Most of primary sector deal with production of raw materials which may used for further production especially in industrial sector so as to get final goods and services, primary sector includes activities/ sectors such as agriculture, mining, fishing and considered as a main economic sector in Tanzania economy.

## AGRICULTURAL SECTOR

This is an economic sector which deals with crop production (cultivation) and livestock keeping.

Agriculture sector is the main primary sector and considered as a leading Economic sector in Tanzania because it contribute large percent of gross national product (GNP) and provide employment opportunities to many people in Tanzania.

Agriculture plays a great role in development of other economic sector such as trading and manufacturing sector. Therefore agriculture is the backbone of Tanzania economy.

### **ECONOMIC ROLES/ IMPORTANCE OF AGRICULTURE SECTOR IN TANZANIA**

1. Agriculture sector provide employment opportunities too many people that lead to decline in unemployment problem i.e. large percent of Tanzania employment is based in agriculture sector compare to other sectors.
2. Agricultural sector stimulate increase in GNP and economic growth because it contribute large percent of GDP in Tanzania
3. Agriculture sector assist development of other economic sector such as manufacture sector because it provides raw materials and market for that sectors.
4. It helps country to get foreign currencies due to the export of agriculture products abroad.
5. Agriculture sector increase supply of food product that assists satisfaction of human wants
6. Agriculture sector assist reduction of income inequality because it improve development and income to the people in rural areas that reduce personal and territorial income inequality
7. Agricultural sector assist in improvement of economic infrastructural in transport and communication system especially in rural areas.

### **PROBLEMS FACING AGRICULTURE SECTOR IN TANZANIA**

**The development of agricultural sector in Tanzania is limited/affected by the following problems;**

1. Unfavorable climate conditional i.e. unfavorable temperature and rainfall for agricultural production. This reduces scale of production and gain from agricultural sector because most of Tanzanian's depends on natural climate.
2. Shortage of market. Agricultural sector in Tanzania limited by small extent of domestic market due to the poverty and international foreign markets due to the competition and low quality of products.
3. Low prices and price fluctuations. Most of agricultural products act as raw materials; therefore they are sold at low price and experience price fluctuation which affect gain/ profit to farmers
4. Pests and disease affect agricultural production and limit scale of production and yields from production and some of diseases affect farms which reduce farmer's participation in production which lead to low volume of production and agricultural development.
5. Low level of technology. Tanzania has low development of technology and most of farmers use poor tools and old technique of production this hinder quality and quantity of output produced.
6. Poor/ lack of workable government policies and structure. Tanzania government lack a workable agriculture policies and strategies for improving production, government created many policies but they are not actually implemented effectively in practices and there is not well established continuous follow up for evaluating failure and success of policies.
7. Low level of education and training among farmers. Most of famous Tanzania farmers have no relevant knowledge relating with agricultural provided, they use normal practices sector.
8. Shortage of capital. Most of people has no sufficient capital for investing in agricultural sector which cause small scale production and employment of local tools (low technology) which result to low agriculture production

9. Low development of economic infrastructures such as transport and communication system especially in rural areas which hinder development of agriculture sector.

### **GENERAL SOLUTIONS TO THE PROBLEMS FACING AGRICULTURE SECTOR IN TANZANIA**

**The following strategies may be used to improve agriculture sector in Tanzania**

1. Government and NGO's should provide cheap loans to the people in order to invest in large scale for agriculture development
2. Government and NGO's should adopt different strategies of improving agricultural sector through improving technology especially agricultural related technology
3. Government should improve economic infrastructures such as transport and communication system, government should increase budget of improving infrastructures in order to facilitate movement of agriculture inputs or final goods (agricultural product) to the market
4. Government should adopt price control policy to the agriculture products in domestic market i.e. price floor in order to promote farmers income and agricultural production.
5. Formation of workable policies and strategies. Government should create a workable and strict implemented and followed agricultural policies and strategies in order to improve agricultural production e.g. tax reduction increase in subsidies
6. Government through different authorities such as crop marketing boards cooperation should conduct research both market research and production research in order to improve agriculture production.
7. The use of irrigation schemes rather than depending on natural climate which is unpredictable.
8. Government and NGO's should provide relevant agricultural knowledge through school, seminars and short training to farmers.

### **SPECIAL STRATEGIES ADOPTED BY TANZANIA FOR IMPROVING AGRICULTURAL SECTOR**

**All strategies of improving agricultural sector adopted by Tanzania economy may be grouped into two main approaches**

- i.) **Improvement approach**
- ii) **Transformation approach**

#### **IMPROVEMENT APPROACH**

This is the strategies of improving small scale peasant/ production which deals with improving productivity in agricultural production. These strategies emphasize on small scale production which has high productivity done by using modern method of production rather than local method so as to improve land and labor productivity (efficiency) in order to produce more goods of higher quality. It emphasizes measures aimed at primarily at individual producers.

**Basic ingredients/ methods/ objective/ strategies of an improvement approach in Tanzania are:**



1. It emphasize small scale production of improved method of production
2. Changing from the use of hand hoe to the use of simple labor saving devices such as ox- plough in production
3. Biological innovations such as the use of better seeds and breed etc.
4. The use of modern fertilizers in production process i.e. industrial fertilizers in order to improve land fertility
5. Provision of production incentives e.g. high price of agricultural products.
6. Research and development in order to find solutions of farming problems. etc.

**Basically improvement approach aimed at improving production efficiently and increase in supply. This strategies succeed in increase in employment by enough people to participate, encourage innovations, production cost increase production/ supply of quality and quantity etc.**

### **TRANSFORMATION APPROACH**

These are the strategies of improving agricultural sector which dial with changing from small scale to large scale production of both food and cash crop. This method deals with large scale mechanized agriculture.

Under transformation approach government emphasize the use of modern technique of production in order to improve productivity of factors of production.

**Transformation approach emphasize on the following strategies /objective/ methods of production**

1. Large scale production which includes establishment of plantation or reopening of existed large scale farm.
2. The use of modern tools like tractors rather than or instead of using hand hoe etc.
3. Improvement of economic infrastructures and storage facilities especially in rural areas.
4. Establishment of authorities and organization together with employment of expertise for improving production and market such as crop marketing boards and cooperation.
5. Applying industrial fertilizers and use of modern seeds in production and irrigation scheme.

**Therefore: transformation approach aimed at production in large scale for domestic and international trade in order to get foreign scale increasing employment reducing deficit in the balance of payment increase government revenue and GNP and other benefits of large scale mechanized production**

However it limited by the shortage / absence of sufficient capital, low development of technology, shortage of large portion of fertile land, lack of educated and trained farmers (unskilled) labor, shortage of market and price fluctuation.

### **FLUCTUATIONS OF PRICE OF AGRICULTURAL PRODUCTS IN TANZANIA**

The economic analysis proved that there is no stability of price to agriculture products. These products experience rise and fall in price which much differ from other products such as industrial product. Therefore price of agricultural product fluctuates more than the price of industrial product.

### **FACTORS/ REASONS FOR LARGE FLUCTUATIONS OF PRICE OF AGRICULTURAL PRODUCTS**

1. Perish ability of agricultural products. Most of agricultural products are perishable they cannot be stored for future use therefore they highly supplied when harvested which lead to large fall in price, then there will be series shortage in the future which lead to large increase in price.

2. Agricultural product has long gestation period. During harvesting supply increase that lead to large fall in price but due to long production gestation period supply will fall or remain constant that lead to large increase in price
3. Agricultural product has derived demand. Since they have derived demand fluctuations of price of final goods produced by agricultural product cause large fluctuation of price agricultural products
4. Bargaining power of producing countries /frames most of ago- based economic has low bargaining power which leads to sale of agricultural products at low price and price fluctuations according to the market situation / environment.
5. Agricultural products depend on natural factors such as temperature and rainfall. therefore favorable climate condition will influence increase in production and supply which lead to price fall but unfavorable climate condition discourage production and supply which lead to large increase in price when other factors remain constant.
6. Competition among countries and industrial use of raw materials. Due to competition among countries and use of industrial raw materials like synthetic fibers, or use of raw material saving technique which affect demand for agricultural products and fluctuation of price
7. UN unpredictable production and supply i.e. over production and supply cause fall in price while under production and supply cause rise in price of agricultural production

### **THE EFFECTS OF PRICE FLUCTUATIONS OF AGRICULTURAL PRODUCTS**

**The up and down / rise and fall of price of agriculture /product may have the following effect in an economy.**

1. fluctuations of government revenue in an economy spinally ago – based economy like Tanzania
2. Fluctuations of farmers people income because price fluctuations cause fluctuations of sales revenue and income to formers/ people
3. Fluctuation of level of employment i.e. Increase in unemployment i.e. fluctuations of agricultural price affect revenue and agricultural production that lead to fluctuation of employment.
4. It may cause failure of government plans in different economic activities
5. It discourage peoples investment in agricultural production and decline in agricultural sectors due to the loss obtained as a result of price fluctuations

### **THE ROLES OF AGRICULTURE SECTOR TO THE DEVELOPMENT OF INDUSTRIAL SECTOR**

**Agricultural sector and industrial sector should be developed simultaneously because development of one sector can be used as a catalyst for development of another sector. The following are the way agricultural sector may stimulate development of industrial sector.**

1. Agricultural sector help people/country to earn currency that used for investing in development of industrial sector like purchasing /importing machine and other inputs for industrial production and development.
2. Agricultural sector provide inputs raw materials to industrial sector such as cotton is raw materials for manufacturing clothes: This help to develop industrial development.
3. Agricultural sector provide market for industrial products that stimulate industrial development for example industrial fertilizers purchased by agricultural sector/producers
4. Agricultural sector provide labour reserve for industrial use and industrial development
5. Agricultural sector facilitate improvement of economic infrastructures such as transport and communication system which facilitates industrial development
6. Agricultural sector sometimes facilitate development of technology which may facilitate industrial development when reemployed in industrial sector.

**Note: the explanation above May used/ provide a framework in explaining the way industrial sector facilitate agricultural development.**

## **SECONDARY SECTOR/ INDUSTRIAL SECTOR**

This is economic activities/ sector which deal with converting inputs into output, secondary sector deal with production of final goods and services from raw materials manifesting and construction activities are two main aspect which from industrial/ secondary sector.

Industrial sector mostly take raw materials from primary sector then modifying/ convert into final goods and services. Secondary / industrial sector contribute about / over 20% GDP (22.6%) and over 20% employment in Tanzania economy.

## **THE ROLES OF INDUSTRIAL SECTOR IN TANZANIA**

1. Industrial sector increase government revenue become industrial and activities pay tax to the government
2. Industrial sector provide employment opportunities to many people this reduce the problem of unemployment.
3. Industrial sector provide input to other sectors such as agricultural sector like fertilizes, tractors which assist agriculture activities.
4. Industrial sector provide market for other economic sector like agricultural sector since agricultural sector supply product which act as a raw materials in industrial sector such as sisal e.t.c.
5. It facilitates improvement of other economic sectors like tertiary sector i.e. Transport and communication system.
6. Assisting in supplying food product which used to satisfy human wants.
7. Industrial sector facilitate growth of town and cities for example Tanga, Dar es Salaam.

## **PROBLEMS FACING INDUSTRIAL SECTOR IN TANZANIA ECONOMY**

1. Shortage of raw materials/ input used in production of final goods and services. This may be caused by low development of other economic sector like Agricultural sector.
2. Shortage of skilled and efficient labor and management. This contributes to the decline in production and low development of industrial sector.
3. Lack of reliable enough market for industrial product both domestic and international market
4. Lack of reliable power and water supply for industrial use i.e. frequently electricity cut off this limit industrial development
5. Low government support (policy) government has no workable policy of providing subsidies and tax reduction for industrial development
6. Shortage of capital. This limit large investment and production and failure to enjoy economies of scale.
7. High initial and operational cost , this problem arise due to the shortage of inputs and some of them imported abroad that lead to increase in cost (price) of input and lead to low profit
8. Low development of technology. This problem reduce efficiency of industrial that cause low quality of products and low output produced
9. Low development of economic infrastructure such as transport and communication this limit movement of either raw materials from different place to produce area or final goods and services from production area to the market place.

## **INDUSTRIAL DEVELOPMENT STRATEGIES IN TANZANIA**

Since independence Tanzania government adopted two main strategies of improving industrial activities

1. **Import substitution activities strategy(1961-1975)**
2. **Basic industrialization industry strategy (1975-1995)**

### **THE IMPORT SUBSTITUTION INDUSTRIES STRATEGY**

This was the policy adopted by Tanzania government which aimed at producing goods and services formerly imported from other countries. That means government decided to established domestic industries of producing goods or service which satisfy domestic human wants in order to reduce the deficit in the balance of payment made abroad so as to reduce deficit in the balance of payment . Import substitution industry strategy started on 1961 to 1975 as industrial development strategy since independence

### **OBJECTIVES/ IMPORTANCE OF IMPORT SUBSTITUTION INDUSTRIES STRATEGY**

1. To serve the foreign currency reserve formerly used to import goods and services
2. To increase the level of employment of factors of production i.e. labour employment
3. To earn foreign currency from export action of goods and services produced by domestic industries
4. To rise government revenue because industrial will increase tax base and amount of tax revenue collected by government.
5. To stimulate improvement of technology due to technique of production
6. Increase in market for domestic raw materials for example agricultural raw materials
7. Reduction in deficit in the balance of payment because industries increase export while reduce volume of import

### **DISADVANTAGES OF IMPORT SUBSTITUTION INDUSTRY STRAGETY**

**The import substitution industries have the following disadvantages in an economy.**

1. Import substitution industries require protection this goes against the principle of international trade and reduce gain in international trade and retaliation.
2. Increase in payment abroad due to the increase in import of capital goods used to develop import substitution industries like machines and other inputs (raw materials)
3. Industries increase supply of low quality product and low consumer's satisfaction due to the use of low technology in production process.
4. Industrial produce more consumer's goods rather than industries development product ( capital/ capital goods) because capital goods assist further industries development
5. Some of industries produce surplus commodities to the domestic market this may regarded as wastage of resources and loss to the companies/ industries.

### **DIFFICULTIES/ PROBLEMS IN IMPLEMENTING IMPORT SUBSTITUTION INDUSTRY STRATEGY**

1. Shortage of foreign currencies for importing capital goods and technology used in production.
2. Shortage / lack of reliable raw materials which limit production and increase cost of importing of some of raw materials
3. Shortage of skilled and trained labor of producing goods and services in an established industries
4. Lack of reliable power supply this cause rise in cost of production and sometimes failure of production

5. Low management skills among managers and government intervention in industrial activities and decisions
6. Shortage of capital fund for large scale investment this cause small scale production and failure of most of industries to enjoy economies of scale

### **BASIC INDUSTRIALIZATION STRATEGY (1975-1995)**

This was industries development strategy aimed at establishing and development industries which produce capital goods rather than final goods and services.

Basic industrialization strategy started in 1975 to 1975. In implementing this strategy Tanzania government established many industries such as Tanga Fertilizers Company, Wazo cement, making factor; Kilimanjaro machine tools, kibaha sub- scania car assembly UFI, ZZK- mbeya SPM- mogololo- iringa and other industries.

Basic industrialization strategy promote production of capital goods for further investment and industries development reduce deficit in the balance of payment, through reduction of importing capital goods, promote development of technology, reducing dependence on foreign capital and creating strong economic base, saving foreign currency reserve used for importing capital goods.

### **TERTIARY SECTOR**

This is an economic sector which deals with service provision to other economic sector or people in an economy. This sector does not deal with physics production of goods but provide services which assist production, competition, exchange, distribution and consumption activities. Tertiary sector includes activities such as banking, insurance, communication, transport, warehouse and other aids to trades **tertiary sector also called services sector.**

### **THE ROLES/ IMPORTANCE OF TERTIARY SECTOR**

1. It helps movement of goods and service or raw materials from one place to another i.e. production area to the market place for exchange this done by transport services.
2. It help to make goods available in the markets at the right time when they are needed this done by storage transport and communication service
3. Tertiary sector protect loss in production either on product or firm in general this facilitated by warehouse and insurance services
4. It facilitates trade transaction and saving activities through banking service.
5. It helps to expand the size of market and sales volume through market research which is facilitated by transport and communication system
6. Provide employment opportunity to many people in difference activities done in tertiary sector this reduce the problem unemployment
7. Facilitates increase in government revenue through tax revenue collected in tertiary activities.

### **OWNERSHIP PATTERN**

This is the structure aspect of Tanzania economy based on system of ownership of major means of production in Tanzania economy. The system of ownership in Tanzania divided into three (3) main systems

1. **Public ownership**
2. **Private ownership**
3. **Cooperation ownership**

### **PUBLIC OWNERSHIP**

This refers to the system of ownership where by major means of production (resources) are collectively owned by government and major means and economic decisions made by government through central government authorities on behalf of society.

### **ADVANTAGES OF PUBLIC OWNERSHIP**

1. Public ownership is preferable and assist in smooth provision of basic/important service in an economy in order to avoid competitive supply e.g. electricity water supply
2. Public ownership reduce the problem of income inequality in the society because of absence of private ownership of major means of production
3. Public ownership facilitates provision of goods since private sector fails to afford while government may afford.
4. Public ownership facilitates supply of goods and services which are not profitable but essentials in an economy for example defense and security, public goods like roads
5. Public ownership reduce resources wasteful competition and utilization of economic resources because government plan on effective and efficient way of utilizing resources
6. Reduce economic instability (crises) such as inflation because government control resources and other problems/instability
7. Playing important role in providing employment to the people i.e. reduce unemployment problem.

### **DISADVANTAGES OF PUBLIC OWNERSHIP**

1. Most of public ownership firm and companies are not efficient in providing goods and services e.g. TANESCO in supplying electricity this is due to the absence of competition
2. Public ownership may lead to public monopoly and all problems of monopoly markets
3. It may cause resources misallocation of resources due to political and social reasons
4. Public ownership cause low production and supply of goods and services of low quality this cause failure of public firm to enjoy economies of scale. This caused by lack personal commitment and poor management
5. It increase government burden in terms of cost and of operating public enterprises
6. Public ownership reduce consumer's choice and satisfaction of human wants due to the shortage/lack of varieties of output

### **COOPERATIVE OWNERSHIP**

This is the system of ownership where by economic resources are owned by two or few people for the group benefits. That means resources or business enterprises are collectively owned by two or more people or between people and government for joint benefits.

Cooperative ownership which occurs between government and private enterprises also known as joint venture. And cooperative societies/union which discussed more the topic of marketing and distribution.

### **PRIVATE OWNERSHIP**

This refers to the system of ownership where by major means of production are owned privately and decision made by private enterprises for private benefits i.e. profit maximization

Most of private enterprise which emerge as a result of private ownership make private decision without interference from government such as what to produce, where to produce, when to produce and how to produce for profit maximization.

## **ROLES/ ADVANTAGES OF PRIVATAGE SECTOR OWNERSHIP / NON-GOVERNMENTAL ORGANIZATION (NGO'S)**

1. Private sector increase job opportunities and better payment to many people compare to public sector ownership
2. Most of private sector (firms) are efficient and lead to increase in supply and quality of goods and services.
3. Private ownership /sector facilitate transfer and improvement of technology from one country (MDC'S) to another (LDC'S) like Tanzania
4. Private sector/ ownership help to increase government revenue because they pay tax to the government
5. Private sector stimulate competition which discourage occurrence of monopoly and negative effect of monopoly, also it stimulate efficiency in production.
6. Facilitate effective and efficient utilization of resources in an economy
7. Reduce government burden in control and finance public firms

## **DISADVANTAGES OF PRIVATE SECTOR/ OWNERSHIP**

1. Private ownership sector/cause wasteful competition and utilization of economic resources
2. Private sector increase the problem of income inequality and economic/ regional imbalance
3. It may cause increase in price and cost of living this increase hard ship in people's life and poor living standards.
4. It may cause failure of government plan because of presence of large private sector which are efficient enough to operate against government will and plans.
5. It may cause cutthroat competition which lead to decline weak firms and unemployment problems.

## **TYPES OF PRIVATE SECTOR**

There are two main types of private sector

1. **Formal private sector**
2. **Informal private sector**

### **FORMAL SECTOR**

These are private sector established and operated by following government rules and regulations laid down by government for controlling private sector. Most of formal sector are large sector

### **INFORMAL SECTOR**

These private sector established and operated without following strict rules and regulation laid down by the government for under taking such activities in the country example of informal sector are street vendors

## **CHARACTERISTICS OF INFORMAL SECTOR IN AN ECONOMY**

1. They use small initial and running capital in production
2. They produce in small scale. This is because of using small initial and running capital
3. They use low level of technology and local tools in production



4. Most of them has no permanent places i.e. business unit has no specific and permanent place for their activities

### ROLES/IMPORTANCE OF INFORMAL SECTOR IN TANZANIA ECONOMY

1. Provide employment to many people. This is sector employ many people because Tanzania has large number of less/ uneducated and low income earner. Who has no sufficient fund, so they decided to participate in different work such as tailoring, cooks, carpentry etc.
2. Increase supply of cheap goods and services in the market which lead to increase in consumer's choice and satisfaction
3. Reduce social evil/ problems in an economy since informal sector provide employment to many people, social evils such as robbery are reduced in an economy
4. Some of informal sector pay tax to the government and other deductions which increase government revenue
5. Reduce income inequality because informal sector improve income to low income earner
6. Stimulate competition with formal and public sector which lead to increase efficient in production and distribution of commodities
7. Increase resources utilization. Since they participate in land utilization and of their natural resources in production process.
8. Stimulate innovation and invention which leads to improvement of technology in production.

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## ECONOMIC GROWTH AND DEVELOPMENT

- **Economic growth** is the quantitative increase in national income produced in an economy. OR Economic growth is the increase in the market value of the goods and services produced by an economy over time. It is conventionally measured as the percent rate of increase of real gross domestic product, or real GDP.
- Economic concerned with increase in size of national income / growth National product (GNP, Therefore economic growth concerned with increase in level of output produced in an economic without considering social and political aspects of the economic.

### DETERMINANT OF ECONOMIC GROWTH

The level of economic growth may determined by various factor. There are:-

1. **Availability of Natural resources** (Natural endowment )

Natural resources may include all natural endowment such as soil, forests, minerals resources, climatic situation and so on. Therefore if country endowed with that resources and well used in production size of output will increase (economic growth) and if not available will course low level of economic growth.

2. **Human factor / availability of quantity and quality labor force** -country which has strange number of labor force and high quality(skilled labor), these labor may engage in production activities and make effective utilization of Natural resources which lead to high economic growth , While unavailability of skilled and unskilled labor course low rate of economic growth.



3. **Technology progress /state of technology.** -Improvement in state of technology may cause people to use modern tools in production process which cause large production and economic growth while low level of technology also may lead to lower economic growth.
4. **Availability of capital and capital accumulation.** -Country with high level of capital and being able to accumulate capital will be able to produce more goods and services while country with less capital will produce less and lead to low level of economic growth.
5. **Political situation:** - This includes political stability and instability, country with political and social stability create conducive environment for investment and production which lead to high rate of economic growth , while political and social instability discourage investment and production which cause low rate of economic growth.
6. **Investment and economic policies of government formula,** conducive economic and investment policies such as low tax increase in subsidies, less documentation and procedure in investment may encourage investment and cause high rate of economic growth and poor policies may hinder economic growth, economic policies also includes improved economic infrastructure, economic stabilization policies etc.
7. **Availability of entrepreneur and entrepreneurial ability** -country with large number of entrepreneurs and many people with entrepreneurial ability will be able to establish and run successful business unit that will produce more goods and services and high rate of economic growth while less number of entrepreneur reduce investment and economic growth in an economy.

## **EFFECTS OF ECONOMIC GROWTH IN AN ECONOMY**

**Economic growth in a country like Tanzania may have both positive and negative effects.**

### **1. POSITIVE EFFECTS OF ECONOMIC GROWTH**

#### **1. Increase in per capital**

Economic growth cause increase in output produced and National income (GNP) this may cause rise in per capital income which may be associated with improved living standards.

#### **2. High level of employment**

Increase in production of goods and services cause increase in demand for factors of production which lead to the increase in employment level i.e. employment of labor

#### **3. Rapid industrialization**

Economic growth facilitate increase in demand for industrial goods and increase in production will may cause increase in industrial activities in an economy

#### **4. Improvement in economic infrastructure**

Population/ government may enjoy improved infrastructure due to their economic growth because government and private sector may improve road, railways, airways and communication system when economic growth occur.

#### **5. Diversification of an economy**

When there is economic growth, country may enjoy diversified economy. Because, economy may grow well if there is diversified economy i.e. economy composed of many sectors which are almost equally development.

#### 6. Increase in utilization of resources

High economic growth means resources are well utilized in production, therefore these may give effects of effective/high utilization of resources.

#### 7. Growth of town / urbanization

Due to economic growth of economic activities such as industrial and trading activities may cause growth of towns or urbanization in an economy.

### NEGATIVE EFFECTS OF ECONOMIC GROWTH

**Apart from positive effects economic growth may have Negative effects in an economy, these are:-**

#### 1. Environmental degradation

Due to rapid economic growth and industrialization, environmental degradation such as pollution, deforestation, soil erosion may occur in a country.

#### 2. Over exploitation and wasteful utilization of resources.

Economic growth cause excessive demand for economic resources like soil, mineral, which then cause over exploitation and exhaustion of such resources.

#### 3. Income inequality and unequal development

Economic growth does not consider how income distributed among people in a nation and unequal distribution of industries and development in a country.

#### 4. Rural – urban irrigation

This may occur due to increase in economic activities in urban areas while rural area lag behind, this will attract many people to leave rural to urban so as to get employment and enjoying urban area, this reduce level of economic activities in rural areas.

### ECONOMIC DEVELOPMENT

**This is the quantitative and qualitative improvement in an economy it includes improvement in welfare of people.**

Some of definitions by different economists.

#### **According to Higgins**

‘Economic development is a permanent rise in total and per capital income of a country, widely diffused throughout occupational income groups continuing at least for two generation and becoming cumulative’

#### **According to Adleman who provide broads definition**

“The process by which an economic development transferred from one whose rate of growth of per capital income is small or negative to one in which a significant self – sustained rate of increase of per capital income is a permanent long run feature.”

Therefore economic development measured by change in National income of an economy over a long period of time and changes in per capital income.

## INDICATORS OF ECONOMIC DEVELOPMENT

The following are indicators of economic development.

### 1. High per capital income

High per capital income is the indicator of improved economic development because developed countries produce more goods compare to rate of population growth which causes high per capital income. .

### 2. Equal income distribution and development.

In order country to be considered as developed country there should be equal regional development and equal income distribution or fair income distribution in an economy.

### 3. Low or Absence of Economic instability

Developed countries has low or no economic instability and has stable economic situations such as stable price level, stable budget, No deficit budget and favorable balance of payment.

### 4. Social and political stability

Developing country has no social unrest and political instability such as war, conflicts of region, political parties or tribal's and has improved social services.

### 5. Decrease in illiteracy rate and increase in supply, of efficient labor.

### 6. Low death rate and height life expectancy

Developed country has low death rate due to improved food supply and improved health services, this cause people to enjoy high improved health services, this cause people to enjoy life expectancy

### 7. Urbanization and improved infrastructure.

### 8. High level of investment and rapid industrialization in an economy.

## INDICATORS OF DEVELOPING COUNTRIES

The indicators of developing countries like Tanzania are as follows:-

**1. Low per capital income**

Developing countries still have low but growing per capital income. This may be due to high rate of population compare to increase in National income / economic growth.

**2. Population pressure and back ward population**

Developing countries has high population pressure and slow process of economic development also large percent is illiteracy/literacy is too low (backward population).

**3. Low technology and industrial development**

Backward technological advancement limits production efficiency which leads to low production and industrial development.

**4. Unfavorable Terms of trade and balance of payment.**

**5. Increase in level of dependency**

This means country depends on another Nations is achieving a desired goals or objectives

**6. Increase in burden of debts,** most developing countries has many debts due to the increase in dependents abroad and development in one sector in a country.

**7. Under utilization of resources and labor unemployment**

**8. Low level of national income (GNP) and living standards.**

## **THEORIES OF ECONOMIC DEVELOPMENT**

### **THEORY**

These are statements or group of statements established by reasoned argument based on known facts intended to explain a particular fact or events.

Theories of social and economic development offer arguments that try to explain the process of social and economic development

**In economic part of view theories of economic development are many but we will study only five theories of economic development these are:-**

### **ROSTOW'S STAGES DEVELOPMENT THEORY**

Rostow's stage of development theory, is the theory used to explain about economic development, This theory developed by American Economic historian, W.W Rostow in his book called "The stages of Economic growth" in 1960, this theory create Rostow as a sole introduce of concept of stages of economic growth and development .

**According to Rostow's theory** "it is logically and practically possible to identify stages of development and to classify society according to stages.

Rostow categorize development of a Nation by taking into account things like productive capacity and technological advancement, Accumulation of capital and resources utilization, saving and investment together with trade both domestic and international trade.

According to Rostow, all countries must pass through those stages of economic growth during the process of development.

**There stages divided into five main categories / stages:-**

- (i) Traditional society
- (ii) The pre conditions for takeoff (Transitional stage)
- (iii) Take off
- (iv) Drive to maturity

1. The Age of high mass consumption.

### **Stage 1. THE TRADITIONAL SOCIETY**

In this stage economy is dominated by subsistence activity where output is produced and consumed by producers rather than traded. Trade (if any) is carried out by barter trade where goods are exchanged directly for other goods. In traditional society there were limited production function based on technology. Agriculture is the most important industry or sector of an economy and production is labor intensive using only Limited tools or quantity of capital, families play great role in production and resources allocation is determined very much by traditional methods of production. Finally traditions, family and clan play role in social organization and there is limited change.

### **Stage 2. THE PRE CONDITIONS FOR TAKE OFF (Transitional stage)**

This is the second stage of growth which brings society in the process sensitive i.e. the period when pre conditions for takeoff are developed. During this period society tries to adopt changes and tries to foregone traditional and leads towards take off main characteristics of this stage, is changes in altitude from accepting that economic environment is beyond control to altitude that people may control economic situation by systematic procedures which lead to economic growth. Main features of this stage is increased specialization generate surplus for trading, there are emergence transport infrastructures to support trade, income, saving and investment grow, entrepreneurs emerge, international trade occurs through concentrating on primary products, during this period people start to improve technology and science and industrialization start

### **Stage 3. TAKE OFF STAGE**

The take off stage is the interval during which rate of investment and industrialization increases, thus changes initiated by change in technologies of production and disposition of income flows.

In this period shift from Agricultural section to industrial sector and growth concentrated in few region of the country.

**According to Rostow take off stage is characterized by three main conditions (events), there are:-**

(i) Necessary but sufficient condition is that, rate of investment rise from 5% to 10% and above of GNP / National income the growth is self sustaining as investment lead to increasing incomes in terms of generating more saving to finance further investment.

1. The existence of one or more substantial manufacturing sector with high rate of growth.
2. Existence or quick emergence of a political, sound and institutional framework which exploit the impulse to expansion to a modern sector and give to the growth /development process an ongoing character.

#### **Stage 4.THE DRIVE TO MATURITY**

During this period economy progressively grows and diversifying into new areas. There is technological innovation and progress which provide diverge range of investment opportunities, new industries established and people invest large percent of National income (up to 20%). Economy produce wide range of goods and services and find new place in international economy and goods exported. Also goods initially imported are produced and country reduces reliance on imports.

#### **Stage 5.THE AGE OF HIGH MASS CONSUMPTION**

This stage also called stage of high living” In this stage economy is geared towards mass consumption leading sectors shift towards durable consumer goods and services.

According to Rostow free choices are expected to overcome scarcity and to result in progress through the automatic adjustment of free exchange in the markets. Therefore force of competition ensures economy to produces the goods which people desire and maximum output produced in the most efficient manner.

In this stage productivity increase and produced goods which satisfy all society’s demand. Countries like USA, France, Japan, German, and Russia reach at this stage.

### **CRITICISMS ON ROSTOW’S STAGES OF ECONOMIC**

#### **GROWTH THEORY**

Rostow’s Stages analysis has been criticized by certain economists in the following grounds.

1. Most of critics on whether a valid and operationally meaningful distinction can be made between stages of development, especially between the transactional phase and take off stage and between take off and maturity. This mean’s Rostow fail to provide unique characteristics that may distinguish his different stages.
2. According to Kuznets it is difficult to make empirically. Testing of the theory which Rostow himself makes no attempt to do. I.e. there is no quantitative evidence for assertions made and some of characteristics of stages as analyzed by Rostow are not specific and sufficient to define the relevant empirical evidence even if data were available.
3. Another critic a rise on whether Rostow used scientific method and people criticized and said Rostow develop theory with using scientific method and use unscientific method and common practice of observing phenomenon, developing hypothesis on the basis of phenomenon, and using phenomenon to support the hypothesis.
4. Rostow’s view fail to explain well about Nature, causes and objectives of development, if tends to focus on constraints or obstacles (patricianly lack of capital) and theory show little input on natural resources on development.

5. Many development economists argue that Rostow's model was developed with Western cultures in mind and not applicable to LDC'S like Tanzania.

## **ROSTOW'S THEORY ON UNDER DEVELOPMENT**

**The use of Rostow's model as a framework for analysis of the process of development assumes that present day developed countries were once underdeveloped and all countries move through all these stages of growth. But this as historical experience indicates is not the case for many third world countries particularly African countries, this argued by different economist as follows:-**

For these African countries under development is not natural stages of human development, Africa appears to be moving backwards, or developing in zigzag manner and not in linear as suggested by Rostow's.

It is difficult to situate African countries in Rostow's stages of development, are these countries still in the "traditional stage" or are they near "take off" indeed one can conclude that African countries do not fit in any of Rostow's stages, others can argue that Africa is moving to yet another stage of development before the "traditional stage" because of growing poverty and dependency on the developed capitalist countries.

Rostow's stages and thesis is incorrect because they do not correspond at all to the past or present reality of the underdeveloped countries. Rostow does not take into serious consideration the historical experience of the underdeveloped countries or the continuous exploitation of these countries by Ruthless multinational/international companies and exploitation by slave trade, colonialism and by imperialist's expansion.

Are we then to conclude from all this that Rostow's contribution is of little value. The answer must be in alternative, because Rostow seems to provide little explanation on African development.

However one cannot fail to note that Rostow offer some extremely valuable insights into the development process, particularly economic development is more or less determined. Also theory is useful since it provide useful background to understand how development is going in different countries and some of characteristics of Rostow stages are relevant and exists in some countries in process of development.

## **MARXIST THEORY OF DEVELOPMENT**

**Marxist theory of development** is the developmental theory named after "German philosopher Karl Max who lived during the 19<sup>th</sup> century. This theory developed in early period of industrialization in such nations as England, German and the United States. In this period majority of people were poor in industrial society. Those who owned and controlled the factories and major means of production exploited the mass that worked for them the rural poor were forced or hired into cities, there employment were available in the factories and workshop and paid at subsistence level as stated in most law of wage.

Marx tried to understand institutional framework that produced such conditions and looked for a means to change in order to improve the human condition.

On development of society Marx argues that, the entire history of human societies may be seen as the history of class conflicts, the conflicts between those who own and control the means of production and those who work for them – the exploiters and the exploited, He believed that ownership of the means of production in many society determines the distribution of wealth power and even ideas in the society. The

power of the wealthy according to Marx also derived from the control of the political, educational and religious institution as well.

Marxist theory suggested two main perspective / element of development first is “changes are due to class struggle and the working out of contradictions inherent in social and political phenomenon in a society.

**Second element of Marxist is material approach to history:**

These means development of productive forces and economic activities in central to historical change and operate through the class struggle, struggle over distribution of the social product/surplus.

Marxist believed that a socialist society is both the necessary and desirable end of historical development in his theory Marx said social development take place in stages and categorize these stage into five stages of social development.

**Marx’s five (5) stages of development of a society are:-**

- **Primitive communalism**
- **Feudalism**
- **Capitalism**
- **Socialism and**
- **Communalism / communism**

- **PRIMITIVE COMMUNALISM**

This also called communal mode of production, it marks the rise of society from sheer animal to human society. Labor were crude productive force in this stage and not well developed which cause primitive man, unable to engage in production alone without the help of other, ownership were communal ownership, Relationship of production were collective, people lived together and jointly conduct their activities for survival, there where low labor productivity, No surplus, equal distribution of products and wealth, No classes and therefore No state, Kingdom and people organized themselves in clan or family in this stage level of development were very low / no.

- **FEUDALISM**

This also called feudal mode of production. It was based on primitive property of land and feudal estates were the man’s source of wealth, it consist of two classes, the land owners and the serfs , landlords exploited the serfs and required to offer their labor force in order to get – rent. This were classes between them which make serfs struggled to free themselves from his exploitative relationship struggling and growing class lead to disintegration of feudalism.

However there is development in this stage in Agriculture, rapid increase as production due to improvement in food, growth of towns as production centers, development of traders and land owner enjoyed both political and military autonomy.



- **CAPITALISM**

This emerged as the result of the industrial revolution in Europe, land as a major failure in capitalist replaced by capital and serf man replaced by wage labor, this lead to emergence of commodity production, relationship in production is exploitative, owner of means of production exploit workers, working class exploited by selling their labor cheaply. During this period weaker farm collapse and societies were well developed using modern tools and land to development. However contradiction between capital and labor leads to downfall of capitalism.

- **SOCIALISM**

This established after overthrow of the capitalist system, socialism establishes the dictatorship of the working class, all means of production were in hand of working class, and relationship of production was non antagonistic / non exploitative relations.

According to Marx socialism is the logical stage of social development after mature capitalism.

- **COMMUNALISM / COMMUNISM**

This is supposed to be the highest level of social development, where there is no exploitative relationship of production, investment and consumption are determined by National plan.

From Marxism perspective development seen as the unfolding in human history of the progressive emancipation of people and nation from the cost of Nature and from a control of other people and Nations.

### **CRITICISM OF MARXIST THEORY**

1. Marxist theory is often criticized by modern in theorists for concentrating too much on conflict, class struggle and changes as a factor for development and gives less concentration on what produce stability in society.
2. Marxist analysis does not make critical analysis of African's unique situation for the resistance, what kinds of classes existed in Africa the Nature of class struggle in Africa etc. This argue Marxist theory as incomplete, this argued by new Marxist theory this attempts to provide answers to the prevailing state of under development and backwardness of third world.
3. Also Marxist criticized by being too ideologically based through those who paid forward this argument however failed to refute the existence of conflicts and class struggle society.

**However it's important to emphasize that Marxist theory remain significant this because;**

Fist Marxist's ability to highlight the exploitative Nature of the of the capitalist economic system and how this gives rise to classes and conflicts which is of great relevance as most African countries have embarked on the road to capitalist development

Marxist theory is able to provide a descriptive and predictive of social life the theory is able to provide a descriptive and predictive of social life, the theory is able to provide a descriptive picture of social economic for motions, especially that of capitalist economic system.

It is main strength lies in its analysis of social relations that a rise in the process of production and the conflicting social class that are eventually the motive force of development.

### **MODERN THEORIES OF ECONOMIC DEVELOPMENT**

These are theories used to summarize modern transfer nations of social life. These theories look at interval factors of countries can develop as modern countries. These theories assume with help “traditional” countries can develop in the some ways “modern” countries did.

Modernization theorist believe many things are involved in the development process these includes market, resources, infrastructures, organization and entrepreneurship and investment all of which are related to one another, most of modern theories said development is a gradual advance of growth through progressive changes.

Modern theories of development includes Rostow stage model, Regner Nurkse (viscous circle of poverty) theory of development of motive force, process and goal (J. Schumpeter) etc.

### **VICIOUS CIRCLE OF POVERTY THEORY**

Regner Nurkes was the prominent economist professor who attempted to examine problems of capital’s formation in underdeveloped countries. The theory express the circular relationship that effect both in demand and the supply side of problem of capital formation in economically backward areas.

*According to Nurkes “A society is poor because it is poor”*

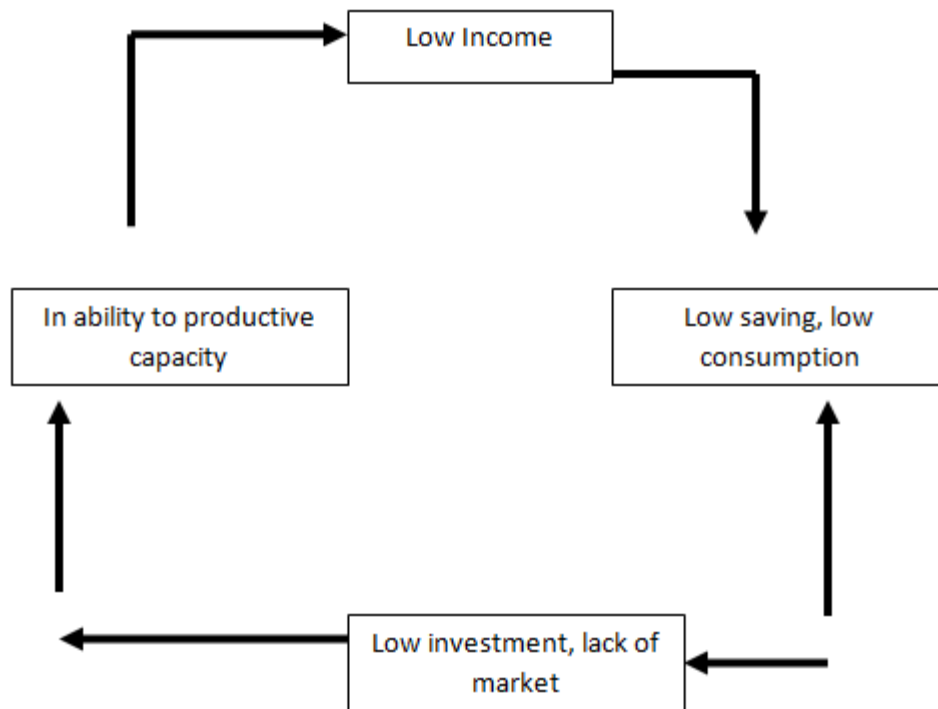
A society with low income has both low levels of saving and low level of consumption while the low levels of consumption means not enough market to induce investment even if the capital for investment were available. This low level of investment in turn means little ability of the society to expand its productive capacity or transform the quality of the productive force as whole. This in turn/finally leads to a continuation of low incomes in the society / economy and then circle begins again.

According to Nurkse the backward countries have failed to enjoy the stimulating effects of the manufacturing industries because of limitation of the market for manufactured goods and not the weakness of foreign capitalist and their exclusive when with raw material surplus.

What is the way out of this circle 3 The answer according to nurkse to enlarge the market, Application of capital must be made to a wide range of different industries, this will lead to enlargement of the market also Nurkse emphasize the doctrine of “balanced growth”.

Nurkse in 1953 made observation that on an underdeveloped economy, characterized by “Vicious circle of poverty” the investment programme must be both massive and balanced for growth to occur.

### **NURKSE’S VICIOUS CIRCLE OF POVERTY**



### THE RELEVANCE OF NURKSE'S VICIOUS CIRCLE THEORY

While there is no/little doubt that third world countries particularly those in Africa are locked in a vicious circle of poverty, the theoretical cause of poverty /historical cause of poverty are not underlined by vicious theory.

The reality way of this theory also ignored by Nurkses theory, theory ignores the reality of under developed countries characterized by dependent economics which make it impossible to create an environment for massive investment and balanced growth.

Nurkse was however not very optimistic about the role of foreign aid in developing countries and instead emphasis on domestic saving and the role of the state as important factors for balanced growth.

However, Nurkse's theory succeeds in indicating the extend of poverty / backwardness of the developed countries through it thrown very little on owner understanding of the causes of poverty or backwardness.

### SCHUMPETER'S THEORY OF MOTIVE FORCE, PROCESS AND GOAL

Prof. J. Schumpeter in his book, capitalism, socialism and Democracy also contribute to the development debate. Schumpeter theory hinges on three aspects motive force, process and goal as sources of development.

According to Schumpeter the action of creative entrepreneurs will produce spurts of industrial progress, even though innovation originated each other time in a particular industry, the monetary effects and other circumstances were such as to promote each time a wave of new application of capital over a whole range of industries. According to Schumpeter, Innovation makes profit and may trigger off new innovation in other fields.

According to Schumpeter's model of development, entrepreneurs provide a generating force, the process is innovative and the goal is the establishment of a position of a wealth and power for entrepreneurs.

### **THE RELEVANCE OF SCHUMPETER'S THEORY**

The Schumpeter's theory does not satisfy the case of the less developed countries in fully obvious, entrepreneurs in most African countries is not the man's driving force, innovation is not the most characteristics process (indeed it hardly to exist) and private enrichment is not the dominant goals. Hence the process of innovation and technological development remain outside the development process in most African countries. The goal of private enrichment for the African has yet "take off" as enrichment of multinational cooperative becomes the goal in most African countries.

Another weakness of Schumpeter is that he said development depend on innovations but development does not depend only on innovation but on whether adequate incentives for interpreters activity exist and he neglect the role played by consumption, saving and foreign aids technology, assistance and Non – credit sources of investment in development process.

However strength of the theory is that, it tries to show that development is generated within a society by its own member and development process cannot started or sustained by outside efforts. Theory tries to show important roles played by entrepreneurship embodied in person with innovation.

### **HARROD - DOMAR GROWTH MODEL / THEORY**

These theory developed by two economists, SIR ROY HARROD of Britain and E.V DOMAR of the U.S.A.

According to this theory, level of investment is the main determinant of economic growth and economic growth is determined by level of saving and productivity of capital. Theory also suggests no natural reason for an economy to have balanced growth.

According to this theory growth rate of gross domestic product (GDP) depends directly on National saving ratio(s) and inversely related on the National capital / output ratio (K) i.e. The more the economies save and invest, the faster they can grow but the actual rate of growth is measured by the inverse of the capital output ratio – output capital ratio.

### **GROWTH CONCEPT ACCORDING TO THEORY**

Warranted growth – This is growth rate of output at which firms believe they have the correct amount of capital and therefore do not increase or decrease investment, given expectation of future demand

#### **Natural rate of growth**

The rate at which labor forces expands, a large labor force generally mean larger aggregate output.

Actual growth – The Actual aggregate output change.

Therefore there is no guarantee that an economy will achieve efficient output – According to theory problem arise when actual growth exceeds or falls to meet warranted growth expectations - difference is exaggerated by attempts to meet the actual demand, causing economic instability.

According to Harrods – Domar Model factor explaining/affecting growth rate are saving rate, (s) capital productivity capital depreciation (etc).

Hence increasing the saving rate, increasing the marginal product.

## CLASSICAL THEORIES OF DEVELOPMENT

Classical theory is widely as the first school of economic thought its major developer includes Adam Smith, David Ricardo Thomas Malthus and John Stark Mill.

The classical school of economic development began with the publication in 1776 by Adam Smith “The wealth of a Nation” The book according to Adam Smith identified main determinant of production and growth is resources of production, the book identified main determinant of production and growth is resources of production, the book identified land, labor and capital as the three main factors of production and major contributors to a Nation’s wealth.

According to Smith the ideal economy is a self regulating market system that automatically satisfy the economic needs of the populace/population, He described market mechanism as an ‘invisible hand’ that leads all individuals, in pursuit of their own self interests to produce the greatest benefits for a society as a whole.

Then Adam Smith come with physiocrats ideas in his theory including Laissez – faire but rejected idea that only Agriculture was productive.

While Adam Smith emphasized the production of income David Ricardo focused on the distribution of income among land owners, workers, and capitalists. Record saw a conflicting objective between land owners on the one hand and labor and capital on other arise in the process of production and development, He posited that the growth of population and capital, pressing against a fixed supply of land, pushes up rents and hold down wages and profit.

Rev. Thomas Malthus used the idea of diminishing return to explain Lowing standards in relation to population growth. He argued population tended to increase geometrically outstripping the production of food, with increased arithmetically. The force of rapid growing population against a limited amount of land, meant diminishing return to labor the result according to him is chronically low wages, which prevented the standard of living for most of the population from raising the substance level.

Coming at the end of the classical tradition, John start Mill parted Company with the earlier classical economists on the inevitability of the distribution of income produced by the market system. Mill pointed a distinction between distribution on income produced by market system, Mill pointed to a distinct difference between the market’s two roles **allocation of resources and distribution income**, market might be efficient in allocating resources but not in distributing income. He wrote, making it necessary for society to intervene.

## GROWTH POLICIES OF TANZANIA

Growth policies are those policies or strategies adopted in Tanzania economy by Tanzania government in order to accelerate economic growth and development in Tanzania economy.

**In order to achieve high rate of economic adopt different growth politics or strategies all those grouped into the following policies:-**

1. **Poverty eradication policies** / National development strategies poverty eradication policies include many policies adopted in order to eradicate poverty so as to create strong economic base and economic growth in

this policies Tanzania government formulate strategies such as “MKUKUTA” MKURABITA, economic policies such as monetary and fiscal policies, external development management policies, external borrowing, employment policies, Youth empowerment and other strategies in order to accelerate high rate of economic growth and economic development.

## **2. Sectorial policies**

This is the policy of improving economic sector in Tanzania economy in this policy Tanzania government adopt strategies like establishment of strategies of improving Agricultural sector as a main sector in Tanzania economy. This police include improving Agricultural productivity, government formulate District Agricultural development plans (DADP's and KILIMO KWANZA which is recent policy, also formation of policies for development of other sectors by providing subsidies.

## **3. Creation of sustainable development.**

Sustainable development include the use of National resource for current development without affecting future use of resources, in this policies, government of Tanzania enhance Biological diversity, protection and development on use of sea and ocean. Sustainable production and consumption. Also in order to protect sustainable development URT establish environmental management Act and other policies to ensure environmental sustainability.

## **4. Social justice and inclusion policy.**

In social policies and inclusion, government promote youth development, gender equality and empowerment of women, in this government gender equally in governmental school, employment and other areas such as political opportunities / leadership together with poverty reduction for development.

## **5. Development Cooperation and global partnership for development.**

In this policy URT establish Bilateral development Cooperation, external debt management, external borrowing, debt relief, also managing Aid relationship and formation of management development cooperation / economic cooperation and integration, which may help to accelerate economic growth even development.

## **6. Social progress policies**

These are policies of improving social services in an economic so as to improve economic growth and development, social policies include development of social services such as health services, education services, housing, water and sanitation in an economy.

## **THE ROLES OF INTERNATIONAL TRADE AND FOREIGN**

### **AIDS IN ECONOMIC, DEVELOPMENT**

International trade is the trade among Nations while foreign aid is the assistance country get from developed countries and international organizations such as IFM, World Bank, etc.

The following are roles or contribution of international trade and economic 1 foreign aid in process of development:-

1. International trade and Aid facilitate improvement in technology that may be used in utilization of resources and production process that may facilitate economic development in an economy.
  2. International trade and aid encourage competition within domestic industries, which may aid as a catalyst for increase in production (output) and improvement of quality of goods and services.
  3. International trade expand market for our industries which may facilitate exploitation of resources optimally which may bring development in an economy.
  4. International trade and aids increase revenue and income due to tax and financial aids which may increase international income and used as a capital for investment and production.
  5. International trade and Aid help to get income and assistance for improvement social services such as school, health services and for the development of a Nation.
  6. Foreign Aid and international trade helps to improve economic infrastructures which may create conducive environment for economic activities and development of a Nation.
  7. International trade and Aid help in financing budget which may be used to allocate expenditure so as to bring development in a country.
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