Economics

for Rwanda Schools

Learner's Book
Senior Six

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Introduction to Economics

This Economics textbook will be very useful to the learners using the competence based learning that is a reform of the school curriculum in Rwanda. The many activities therein lay the ground for skills development.

Learners will use the knowledge they learn by developing competences like the ability to think and solve economic challenges or even other daily problems by oneself, being creative and curious about economic issues thus become future developmental citizens.

The book motivates the learners' minds to work out solutions other than waiting for the teacher to spell out solutions or information for them.

The fact that the activities therein are for discussing gives learners a chance to learn from each other and other people. This makes it easily possible to get solutions to economics challenges.

The Research activities or fieldwork will help the learners have hands on learning experience and of course with the help of the teacher.

Topic Area 4: International Economics

Sub-Topic Area 4.1: International Trade

UNIT 1 International Trade Theories

Key unit competence: Learners will be able to analyse the importance of international trade to the development of the economy.

My goals

By the end of this unit, I will be able to:

- Explain the different terminologies used in international trade.
- Discuss the advantages and disadvantages of international trade and its limitations.
- Differentiate between absolute advantage and comparative advantage theories of international trade.
- Assess the gains from international trade basing on its forms.
- Analyse the determining factors of comparative advantage theory.
- Use calculations from production schedule to explain the theory of comparative advantage.
- Analyse the applicability of the comparative advantage theory in LDCs/ Rwanda.
- Advocate for efficient use of available resources to increase gains from the international trade.

1.1. Meaning of International Trade

Activity 1

Figure 1: International trade aspects

Analyze the photo below and answer the questions that follow:

Required:

a) Classify the above photos into the sectors of Rwandan economy.

b) Identify commodities, from the above activities, which are of Rwandan origin and those which are not.

c) In your view, who do you think are the target consumers of such products from the photos above?

d) How do you think those commodities identified in 'b' above as not of Rwandan origin, reach Rwandan markets?

e) How is it different to trade within the country and with different other countries?

International trade is the exchange of capital, goods, and services across international borders or territories, which could involve the activities of the government, companies and individuals. In most countries, such trade represents a significant share of Gross Domestic Product (GDP). While international trade has been present throughout much of history, its economic, social, and political importance has been on the rise in recent centuries. It is the presupposition of international trade that a sufficient level of geopolitical peace and stability are prevailing in order to allow peaceful exchange of trade and commerce to take place between nations.

Facts

Trading globally gives consumers and countries the opportunity to be exposed to new markets and products. Almost every kind of product can be found on the international market: food, clothes, spare parts, oil, jewelry, wine, stocks, currencies and water. Services are also traded: tourism, banking, consulting and transportation. A product that is sold to the global market is an export, and a product that is bought from the global market is an import. Without international trade, nations would be limited to the goods and services produced within their own borders.

1.1.1 Differences between international trade and domestic trade

International trade is, in principle, not different from domestic trade as the motivation and the behaviour of parties involved in a trade do not change fundamentally regardless of whether trade is across a boarder or not. International trade constitutes those activities involving the exchange of goods and services across national boundaries. It differs from domestic trade in the following aspects.

Use of Currency

Transactions in domestic trade involve the use of one currency, normally the national currency or legal tender. For example, in Rwanda's domestic trade, it is the Rwandan francs which must be used for buying whatever is being sold. For international trade though, various currencies may be involved. For instance, if a Rwandan businessman wants to import cars from Japan, the Japanese exporter, who may not be interested in the Rwandan francs, would demand to be paid in Japanese yen or any other hard currency like the US Dollar.

Barriers

Trade within a country is not subjected to barriers restricting the movement of goods internally. Goods produced in Rusizi are expected to have free movement to be sold anywhere in Rwanda. On the contrary, movements of goods across national boundaries are subjected to varying degrees of restrictions — tariffs, quotas. Goods involved in international trade have to pass through designed customs posts.

Standardised goods

Goods exchanged in domestic trade tend to be more standardised than goods in international trade. For instance, they are legally all measured either in metric or imperial standard measurement. If they are vehicles, they may have to conform to either being left-hand or right-hand drive vehicles. Hence, local production is for a standardised market. But this need not be the case in international trade, where the producers confronted with different markets may have a variety of different standards for different markets to fulfill.

Paper work

The paper work involved in domestic trade is normally less voluminous compared to that involved in international trade. There is hardly any paper work involved in the domestic trade.

Costs involved

International trade is typically more costly than domestic trade. The reason is that a boarder typically imposes additional costs such as tariffs, time costs due to boarder delays and costs associated with country differences such as language, the legal system or culture.

Mobility of factors of production

Factors of production such as capital and labour are typically more mobile within a country than across countries. Thus international trade is mostly restricted to trade in goods and services, and only to a lesser extent to trade in capital, labour or other factors of production. Trade in goods and services can serve as a substitute for trade in factors of production. Instead of importing a factor of production, a country can import goods that make intensive use of that factor of production and thus embody it.

1.2 Forms of International Trade

Activity 2

Shyaka, a bee farmer from Rwanda, secured market for his honey in Tanzania just like Neema, a cosmetics producer from Tanzania, also secured market for her cosmetics in Rwanda and there has been exchange of their commodities between the two countries for a long period of time. However, Rwanda has gone ahead to secure market for Mr. Shyaka's honey in various countries in the world, both developed and developing countries. This has created peace and harmony between Rwanda and the partners in trade.

Undertake based on Shyaka and Neema's example, the case study the research about international trade and explain the following?

(a) The term used to explain trade between Rwanda and Tanzania and the trade between Rwanda and more countries.

(b) What are the examples of goods and services that Rwanda exchanges with other countries?

(c) Why do you think it is necessary to create and maintain peace and harmony between or among countries trading amongst themselves?

Figure 2: Bilateral trade images

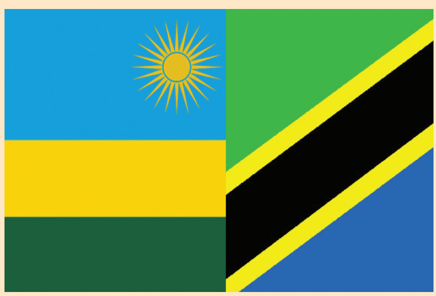
	
Tanzania- Rwanda trade forum 2016	*Tanzania & Rwanda flags*

Figure 3: Multilateral trade photo (multilateral trade agreement)

There are majorly two forms of international trade, namely;

(d) ***Bilateral trade or clearing trade or side deal*** is the exchange agreement between two nations or trading groups that gives each party favored trade status pertaining to certain goods obtained from the signatories. Or the exchange agreement of goods and services between two nations promoting trade and investment. Examples of bilateral trade Agreements that involve Rwanda include; Rwanda and Central African Republic bilateral pact signed in 2019, bilateral investment treaty between Rwanda and Qatar, bilateral investment treaty and the bilateral air services agreement between Rwanda and Singapore.

(e) **Multilateral trade** refers to the exchange of commodities among more than 2 countries. Since they are many countries, it makes them stronger than other types of trade agreements once all parties sign. Some regional trade agreements are multilateral, for example, The African Continental Free Trade Area **(AfCFTA)**, The East African Community **(EAC)**, The Common Market for Eastern and Southern Africa **(COMESA)** and all global trade agreements are multilateral. The most successful one is the General Agreement on Trade and Tariffs [GATT].

1.3 Terminologies Used in International Trade

(i) Exports: These are commodities sold from one country to other countries.

(ii) Imports: These are commodities that are bought from other countries and brought to a particular country.

(iii) Export trade: This is the selling of commodities from one country to another.

(iv) Import trade: This is the buying of commodities from other countries and brought to a particular country.

(v) Visible trade: This is the exchange of commodities that involve only goods. i.e. exchange of tangible or physical commodities between or among countries.

(vi) Invisible trade: This is the exchange that involves only services. i.e. exchange of intangible commodities like education, insurance, health, tourism, etc.

(vii) Basically, entrepot trade is the process of re-exporting goods that have been imported into a country without the package having undergone any repackaging or additional processing. In a case like this, a trader becomes both the importer and the exporter of these goods. An example of entrepot trade is that a certain Rwandan company may import cars from Japan and then exports them to a Ugandan Company. Likewise, if a Rwandan company were to import computers from China and export them immediately to Tanzania, this would be called entrepot trade for Rwanda.

(viii) Balance of trade: This is the relationship between visible exports and visible imports. The relationship can be positive, thus favourable balance of trade or negative, thus unfavourable balance of trade. Balance of trade includes only visible items and does not consider exchange of services.

(ix) Vent for surplus: This refers to the theory which emphasises increased exploitation of domestic idle resources so as to increase exports or foreign exchange hence increasing a country's GDP.

(x) Open economy: This is an economy which is involved in international trade.

(xi) Closed economy: This is an economy which is not engaged in international trade at all.

(xii) Gains from trade: These are advantages which accrue from international trade.

1.4 Need for International Trade

Activity 3

As seen in the introduction of this unit, international trade involves the exchanges of different commodities and capital between or among different countries on the globe. In your own view, express why you think Rwanda participates in trade with different other countries on the globe.

Facts

It is important to note that if all nations had all the goods they require, were equally efficient, and had unchanging tastes, there would be no need for international trade. Since it is impossible to have all such situations in any one country in the world, there is need for international trade between or among individuals, companies and governments of different countries and this is due to the following reasons;

Differences in natural resource endowments

Different countries have differences in factor resource endowments because Mother Nature has not been equally kind to every region or country in the world in her distribution of resources. Since different countries have different types of natural resources and of which are non-transferable, like climate, minerals, oil, etc., and in differing quantities, it is important to participate in international trade to acquire and enjoy the benefits of these resources. This helps a country like Rwanda to preserve her natural resources for environmental sustainability since she can get such commodities outside the country than over exploiting and exhausting the little available non-renewable resources.

Lack of self-sufficiency

A country may be producing a commodity but not in sufficient quantities that it requires, and hence a need for international trade to overcome the shortage. For instance, Rwanda produces sugar but not in sufficient quantities, hence the need to import it. On the contrary, some goods cannot be found in the country at all may be due to lack of natural resources, capital and skilled labour. On top of that, a country may want to get better quality or standard commodities which she cannot produce as a result of lack of skilled labour or technology to produce them. It's the role of the government to avail standard or better commodities for its citizens for better standards of living. Therefore, such a country may engage in international trade in order to acquire the goods it cannot produce.

Need to dispose-off surplus

A country may produce a commodity in excess of what can be consumed by the domestic market. Where the economic exploitation of the resource or commodity requires a larger market than the domestic market, international trade will develop in order to avoid wastage. Similarly, in a situation where a country possesses a resource it does not demand at all but is demanded by other countries, the country would exchange its resources so as to acquire what it needs from other countries. This is known as the vent-for-surplus cause of international trade.

Lack of co-operant factors

A country may be well endowed with natural resources but unable to exploit them either for its own direct utilisation or for exchange to acquire what they need from other countries. This may be due to lack of skills, technology, capital, etc. Exploitation of such resources would inevitably make the country to engage in international trade so as to acquire the vital missing co-operant factors. With international trade, standardised commodities are required in the world market, therefore, if such co-operant factors miss in a country, production won't meet world standards which earns it less from international trade. This makes it a pressing issue for such a country to join international trade to acquire such required factors and meet international standards for the gains from international trade.

Differences in skills

Different people have different skills that may be natural or acquired by training which results into production of different products. The desire for those products beyond one's productive capacity leads to international trade. For example, Rwanda has for long lacked indigenous skilled manpower thus has been hiring expatriates to be used in different sectors of the economy. This has promoted skills development among the indigenous population who work with such experts, a reason behind "made in Rwanda campaign" since most Rwandese have emulated such skills from the expatriates and can apply them in their home country. This has promoted pride and fraternity among the citizens of the country as they consume their own made commodities.

Differences in technology

Nations have differences in technology that enable them to produce different goods and hence international trade arises. For example, Rwanda joined international trade to acquire a better technology to exploit her natural resources, increase production, expand employment opportunities for her population and improve their welfare. This has enabled Rwanda to achieve some of her objectives of development; like achieving sustained economic growth, reducing unemployment and improving standards of living of people thus promoting confidence in the government, togetherness, unity and love for the country by the citizens.

Differences in tastes or demand

International trade might also arise because of differences in tastes. With development, people's standards of living increase and they may demand for not only high quality products but also for a wider variety of goods and services. Thus, even if one country can produce a certain commodity, importation may still take place due to people's desire for a better quality product from abroad. This connects with the idea of competitive forces and the exercise of choice. In a free market economy, consumers are free to choose which goods to buy. A foreign good may be more appealing. This is not necessarily a matter of it being cheaper, but may simply reflect the consumer's tastes.

Comparative advantage

International trade might arise out of the need to minimise the costs of production. It is always wise for one to purchase a commodity if one finds it economical/cheaper to buy than to produce. Thus, when one country finds it cheaper to consume imported goods and services than consuming those domestically produced, it would be engaged in international trade. Some countries may be able to produce given commodities but at relatively higher costs than others may. Therefore, those countries at a relative cost disadvantage may initiate and engage in exchange relations with those countries having a relative cost advantage so as to minimise their costs. This is exchange based on comparative cost advantage.

Need to acquire foreign exchange

Some countries trade because they want to acquire foreign exchange to finance development. Many African countries export their produce to earn foreign exchange. Where domestic revenue isn't sufficient to meet recurrent and development budgets, a country joins trade to exchange her commodities through exports to get revenue to supplement the local sources.

Need to strengthen political ties

Sometimes, international trade may arise simply to promote political ties between the trade participants or to extend a form of political ideology from one country to another. Two similarly ideologically disposed countries may promote trade between themselves even when it is not necessary. However, it would have been advantageous to one country to trade with another country, which is not ideologically favourable. This promotes international unity, peace and harmony which increases the gains from international trade by different countries since it is easy to access markets worldwide.

Need to increase competition and efficiency

Countries need to join international trade in order to increase competition and efficiency between or among themselves. This lowers prices and reduces local monopolies who might cheat consumers through high prices. Competition avails a variety of commodities of good quality since a certain standard has to be met to get market for a country's commodities. This promotes the culture of standardisation among producers so as to maximise their profits through producing what is required by international standards.

Need to reduce subsistence sector

Countries participate in international trade to produce for the market through exporting their commodities which reduces on the subsistence sector and its negative effects. For example, Rwanda participates in international trade with the development goal of transforming the economy from subsistence production to a monetary one. This promotes commercial production and reduces subsistence production. It has also created and expanded employment opportunities to most people thus reducing income gap in the economy. In this case, all people see themselves as important citizens to the economy as the government facilitates them in transforming from low income subsistence status to high status commercial production, thus increasing love and general peace in the country.

Need to promote employment opportunities

International trade promotes employment directly or indirectly i.e. those involved in handling international trade at border posts, collecting taxes, checking standards and those producing for exports.

Vent for surplus

Countries need international trade in order to exploit their idle resources so as to increase their export level and provide employment. International trade widens market, avails skills and techniques of production, all these increase the capacity to exploit resources by a nation. Nations should, properly and efficiently utilise idle resources to compromise environmental sustainability, especially with the non-renewable resources. Otherwise, there could come up global warming which affects the entire world directly or indirectly.

Need for specialisation

Countries prefer to specialise in few commodities in which they are efficient so that they can maximise output and preserve resources. Thus, international trade arises due to the fact that a country would exchange what it produces efficiently for what it cannot. This avoids wastage of resources, little foreign exchange and time in producing a commodity a country is not good at. Therefore, a country has to specialise in production of a commodity where it incurs less real costs or opportunity cost and exchange with others who produce what she cannot produce due to incurring high real or opportunity cost.

1.5 Advantages, disadvantages and limitations of international trade.

a. Advantages international trade.

Activity 4

International trade allows countries, states, brands as well as businesses to buy and sell in foreign markets. It generally diversifies the products and services which can be received by domestic customers. In fact, international trade provides expansion and development potential without risking internal development and research. Trade doesn't lack problems. One of the involving countries may earn great profit through exportation but not the importation of goods and services. Also, it can be used to undercut the domestic market by offering valuable goods at cheaper prizes. International trade has many advantages and disadvantages regardless of the form. https://bit.ly/39WN5Zg

Required:

a) Identify some of the benefits and costs of international trade cited in the above extract.
b) What other benefits and costs, other than those cited in the above extract, are likely to come out of international trade.
c) Explain what you think might be the hindrances to smooth international trade.

Facts

International trade is a basic feature of economic activities in every country. Nearly every country in the world seeks to participate in international trade. Ideally, participation in international exchange confers several benefits or advantages to the participants and these may include among others the following;

- It permits and fosters international specialisation in order to maximise output and costs of production. This therefore leads to increased national income, savings, investment and employment opportunities for the participating countries.
- It overcomes shortages, i.e. if a country engages in international trade it overcomes such shortages brought by for example natural disasters.
- Market expansion: i.e. international trade widens markets for the participating countries e.g. LDCs are assured of markets for their raw materials. This has encouraged LDCs to move from subsistence production to a monetary one.
- Vent for surplus: International trade enables a country to utilise her resources thus full utilisation of resources due to assured markets.
- International trade provides an opportunity to a country to sell a surplus of products and to make use of available land and labour. Many countries have products, which are surplus to their own requirements. It is only by exporting these products that they have any value at all. Without trade, the land and the labour used in their production would be idle. International trade therefore gives the country the opportunity to sell these products and to make use of the available land and labour.
- International trade stimulates competition and forces home producers to become more efficient which leads to a culture of standardisation thus better quality, lower prices and more output.
- It leads to introduction of new ideas, technologies, knowledge and skills, entrepreneurship and social change. Thus the dynamic effects of trade stimulate economic development in the long run.
- International trade provides revenue to the government from import and export duties. This revenue can be used to finance different development activities in the economy, of which revenue would not be enough had there not been international trade.
- Creation and maintenance of employment: i.e. once countries specialise in production of certain goods for export, it follows that there will be employment in those sectors. This increases incomes of people and raises their purchasing power thus promoting more investments in the country.

- Promotes cultural and political ties between or among countries since there is understanding among trading partners which creates global peace and harmony among countries.
- International trade avails a wide variety of commodities which increase the choice of consumers and their standard of living.
- It increases capital inflow: i.e. foreign exchange which it can use to pay off its foreign debts, pay contributions to international organisations and carry out development programmes.
- It enables a country to get relief supplies by importing from other countries e.g. in case it is hit by emergencies like drought, floods and earthquakes.
- It enables factor mobility which promotes exchange of ideas and information thus increase in labour efficiency, solves unemployment problems and brings about development in the long run.

b. Arguments against International Trade

Despite the above mentioned advantages of international trade, it comes with several demerits which include among others the following;

- It encourages dumping which causes price instabilities in the domestic country/market. It also reduces the spirit of love for the locally made commodities which kills domestic production capacity by local producers. This is because most of the dumped commodities are either cheaper or of high quality than the home made commodities. This affects the development path of the country where commodities are dumped.
- Development of local industries is retarded i.e. local industries may be outcompeted by more efficient foreign firms and this leads to increased unemployment and worsens the living standards of people in the domestic economy.
- If a country trades with another that is affected by inflation, it may result into imported inflation on the importing country.
- Loss of social economic and political independence because MDCs always dictate unfair trading terms to LDCs.

- Loss of culture through demonstration effect as consumers of imported goods adapt to foreign consumption habits and cultures. People change towards the imported commodities with a view that they are better than theirs. This reduces love for their country as they reject consuming its locally made commodities.
- International trade may result into over exploitation of domestic resources due to wider markets.
- The desire to serve the wider market leads to the cutting down of forests, draining marsh lands, poaching etc. all which are anti-environmental protection and preservation and anti-environmental sustainability.
- Dangerous commodities may find their way into the country e.g. guns, drugs etc. which may worsen the health and the standard of living of people.
- BOP position may worsen where import expenditure may exceed export revenue. People, due to demonstration effect, free flow of goods and services in the country. This may lead to import expenditure exceeding export earnings thus worsening the BOP position of the country.
- It may limit employment opportunities in the country by the domestic people who are outcompeted by foreigners who might have superior skills over locals.

c. Limitations of International Trade

Facts

A number of both social, economic and political factors can hinder a country to participate fully in international trade. These factors are either internal or external and can be avoidable or inevitable. These include among others the following:

1. Rapid depletion of exhaustible natural resources: It could lead to a more rapid depletion of exhaustible natural resources. As countries begin to increase their production levels, natural resources tend to get depleted with time and it could pose a dangerous threat to the future generation.
2. Import of harmful goods: Foreign trade may lead to importation of harmful goods like cigarettes, drugs, etc., which may harm the health of the residents of the country.

3. It may exhaust resources: International trade leads to intensive cultivation of land. Thus, it has the operations of law of diminishing returns in agricultural countries. It also makes a nation poor by giving too much burden over the resources.
4. Over specialisation: Over specialisation may be disastrous for a country. A substitute may appear and ruin the economic lives of millions.
5. Danger of starvation: A country may depend mainly on foreign countries for its food. In times of war, there is a serious danger of starvation for such countries.
6. One country gains at the expense of others: One of the serious drawbacks of foreign trade is that one country may gain at the expense of others due to certain accidental advantages.
7. May lead to war: Foreign trade may lead to war, different countries compete with each other in finding out new markets and sources of raw material for their industries and frequently come into clash. This was one of the causes of the First and Second World War.
8. Language diversity: Each country has its own language. As foreign trade involves trade between two or more countries, there is diversity of languages. This difference in language creates a problem in foreign trade.
9. Differences in laws and regulations: i.e. different countries have different laws and regulations that govern trade that do not coincide with laws of other countries. This makes it hard for traders from different countries to cope with those laws from other countries thus hindering international trade.
10. Competition to domestic producers: Since goods are not only exported but also imported, people are usually attracted to foreign goods and prefer to buy them instead of goods that have been produced within the nation. Domestic producers face a loss due to this.
11. Cost incurred for exporting: A lot of costs on transportation facilities has to be incurred when goods are exported to other countries.
12. Too much dependence: When countries develop a habit of importing certain kinds of goods from another country they usually reduce the amount of production of the same good within the country so if the country that exports has a problem and is unable to export goods then the country that imports the goods will suddenly face a shortage of those goods.
13. Differences in standards of measurement: Different countries use different weights and measures.

14. Lack of standard currency to exchange commodities: There is no convenient means for buyers and sellers to exchange commodities since they both have different currencies. Exchanging to convertible currencies may distort the relative prices.
15. Inadequate information about goods available, their prices, quality etc. which hinders smooth international trade.
16. Trade barriers which governments normally impose on flow of international commodities like tariffs, quotas, foreign currency, self-sufficiency etc. all limit international trade.

1.6 Rwanda's International Trade

Overview: In 2018 Rwanda was the number 143 economy in the world in terms of GDP (current US$), the number 152 in total exports, and the number 156 in total imports.

In 2018, Rwanda exported $970M and imported $1.98B, resulting in a negative trade balance of -$1.01B. In 2018, Rwanda's exports per capita were $78.8 and its imports per capita were $161.

1.6.1. Rwanda total Trade:

- The top exports of Rwanda are Gold ($637M), Niobium, Tantalum, Vanadium and Zirconium Ore ($76.7M),

  Coffee ($66.4M), Tin Ores ($60.7M), and Tea ($56.1M).

- The top imports of Rwanda are Other Furniture ($120M), Broadcasting Equipment ($94.3M), Baked Goods

  ($81.4M), Plastic Housewares ($77.1M), and Pulley Systems ($70.4M).

Destinations: Rwanda exports mostly to United Arab Emirates ($638M), United States ($66.4M), Thailand ($42.9M), Pakistan ($42.2M), and China ($39.8M), and imports mostly from Tanzania ($667M), Uganda ($197M), Kenya ($176M), China ($165M), and India ($132M).

1.6.2. Rwanda domestic exports:

In 2018 Rwanda exported a total of $970M, making it the number 152 exporter in the world. During the last five reported years the exports of Rwanda have changed by $93.8M from $876M in 2013 to $970M in 2018.

The most recent exports are led by Gold ($637M), Niobium, Tantalum, Vanadium and Zirconium Ore ($76.7M), Coffee ($66.4M), Tin Ores ($60.7M), and Tea ($56.1M). The most common destination for the exports of Rwanda are United Arab Emirates ($638M), United States ($66.4M), Thailand ($42.9M), Pakistan ($42.2M), and China ($39.8M).

1.6.3. Rwanda's product Imports

In 2018 Rwanda imported $1.98B, making it the number 156 trade destination in the world. During the last five reported years the imports of Rwanda changed by -$91.8M from $2.07B in 2013 to $1.98B in 2018.

The most recent imports of Rwanda are led by Other Furniture ($120M), Broadcasting Equipment ($94.3M), Baked Goods ($81.4M), Plastic Housewares ($77.1M), and Pulley Systems ($70.4M). The most common import partners for Rwanda are Tanzania ($667M), Uganda ($197M), Kenya ($176M), China ($165M), and India ($132M).

1.6.4. Market Growth:

- Fastest growing export markets (2017 - 2018)

United States- $23.3M (+ 54.1%)

China- $11M (+ 38.2%)

Pakistan- $8.29M (+ 24.4%)

- Fastest growing import markets (2017 - 2018)

Tanzania- $610M (+ 1.07k%)

India- $42.5M (+ 47.8%)

China- $37.1M (+ 29%).

1.6.5. Service trade:

Rwanda exports services (2015): $493M

Rwanda imports services (2015): $855M

In 2015, Rwanda exported $493M worth of services. The top services exported by Rwanda in 2015 were Government services, n.i.e ($251M), Business travel ($98.4M), Air transport ($87.6M), Communications services ($21.8M), and Construction abroad ($10.5M).

The top services imported by Rwanda in 2015 were other transport ($199M), Miscellaneous business, professional, and technical services ($160M), Government services, n.i.e. ($145M), Air transport ($143M), and Sea transport ($133M).

Source: *https://oec.world/en/profile/country/rwa/#trade-services*

A SUMMARY OF RWANDA'S TRADE PICTURE (2008 -2018):

Product exports (2018): $970m, rank 152 of 222

Exports per capita (2018): $78.8, rank 45 of 219

Product imports (2018): $1.98B, rank 156 of 221

Imports per capita (2018): $161, rank 40 of 219

Service exports (2015): $493M, rank 134 of 170

Service imports (2015): $855M, rank 130 of 170

GDP (2018): $9.51B, CURRENT US$ rank 143 of 196

GDP growth (2008 - 2018): 93.1%, current US$ rank 35 of 196

GDP PC (2018): $773, current US$ rank 179 of 196

GDP PC growth (2008 - 2018):49.5%, current US$ rank 46 of 196.

1.7 Theories of International Trade

There are different theories of international trade as put forward by different economists trying to explain the gains from international trade between or among countries involved. There are two basic principles or theories of international trade, and these include the following;

- Theory of absolute advantage
- Theory of comparative advantage

1.7.1 Theory of absolute advantage

Activity 5

Analyze the case study below, use it to undertake research on international trade theories and answer the questions that follow:

Using the same quantity of resources, Rwanda and Egypt can both produce rice, but Egypt can produce it with fewer resources, a higher quality and less time at a faster rate with greater profit than Rwanda. In the same context, both countries can both produce juice, but Rwanda can produce it with fewer resources, a higher quality and less time at a faster rate with greater profit than Egypt.

(a) What theory of international trade is portrayed in the case study above? Justify your answer.

(b) How will international trade between the two countries be made possible?

(c) Describe how the two countries will benefit from trade?

Facts

Meaning of absolute advantage

This theory, put forward by Adam Smith, was developed to explain the gains from international trade as a result of specialisation between countries. The law of absolute advantage states that "Given two countries and same amount of resources, a country is said to have an absolute advantage over another in production of a given commodity if it can produce that commodity more efficiently at a lower input cost". According to Adam Smith, the law of absolute cost advantage for international trade, operates in such a way that countries will benefit if one of them has an absolute (cost) advantage in producing one commodity while the other has an absolute (cost) advantage in producing the other commodity.

A country that can produce a good at a lower cost than another country is said to have an absolute advantage in the production of that good. Absolute advantage is therefore the ability of a country to produce more of a commodity than its competitors using the same amount of resources.

When two countries have absolute advantages in different goods, there are gains from trade to be reaped. According to the absolute cost advantage doctrine of Adam Smith, each country produces those goods whose production is specially suited on account of its climate, fertility of its land and its natural resources, and acquired capacity of its people, such as plants, buildings, means of transport, education and health. It will concentrate on the production of such commodities, producing more than its requirement, getting the surplus exchanged with goods and commodities from other countries.

The principle of absolute advantage involves comparing the quantities of a specific product that can be produced using the same quantity of resources in two different countries. For example, Rwanda is said to have an absolute advantage over Uganda in the production of tea when an equal quantity of resources can produce more of tea in Rwanda than in Uganda. Suppose that Rwanda has an absolute advantage over Uganda in one product, while Uganda has an absolute advantage over Rwanda in another, this is a case of reciprocal absolute advantage. This implies that each country has an absolute advantage in one product. In such a situation, the total production of both countries can be increased (relative to a situation of self-sufficiency) if each specialises in the product in which it has an absolute advantage.

Assumptions of absolute advantage

The idea of absolute advantage rests on a number of assumptions according to Adam Smith. Here are the most significant of these assumptions:

- **Lack of Mobility for Factors of Production:** Adam Smith assumes that factors of production cannot move between countries implying that the Production Possibility Frontier of each country will not change after the trade.

- **Trade Barriers:** There are no barriers to trade for the exchange of goods. Governments do not implement trade barriers to restrict or discourage the importation or exportation of a particular good.

- **Trade Balance:** Smith assumes that exports must be equal to imports. This assumption means that we cannot have trade imbalances, trade deficits, or surpluses.

- **Constant Returns to Scale:** Adam Smith assumes that we will get constant returns as production scales, meaning there are no economies of scale. However, if there were economies of scale, then it would become cheaper for countries to keep producing the same good as it produced more of the same good.

There are two main assumptions underlying the principle of absolute advantage:

- Labour is the only factor of production;
- Labour is mobile within the country but immobile between countries.

Given the above assumptions, an exchange of goods will occur (assuming a two-country two-commodity case), if each of the two countries can produce one commodity at an absolutely lower labour cost of production than the other.

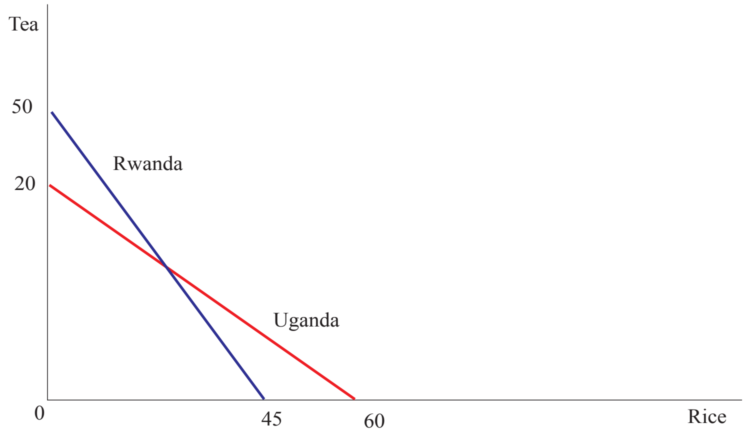
Let us take a two-country two-commodity case. e.g. Rwanda and Uganda producing tea and rice respectively:

Table 1: Reciprocal absolute advantage production schedule.

Country	TEA (tons)	Rice (tons)
Rwanda	50	45
Uganda	20	60
Total before specialisation	70	105
Total after specialisation	100	120

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

Figure 10: Absolute advantage between Rwanda and Uganda using a production possibilities curve.



Basing on the information from the table and graph above, Rwanda will confine itself to the production of tea since it has an absolute cost advantage in producing tea. Through specialisation it will produce tea in larger quantity than its home requirement, getting the surplus exchanged for rice from Uganda. Similarly, Uganda will specialise in the production of rice and, will exchange part of it for tea from Rwanda.

Thus, both countries would have more of both products by trading among themselves, through the application of the principle of division of labour, producing only that product in which each has an absolute advantage over the other. After specialisation, the total production of tea is 100 tons and that of rice is 120 tons.

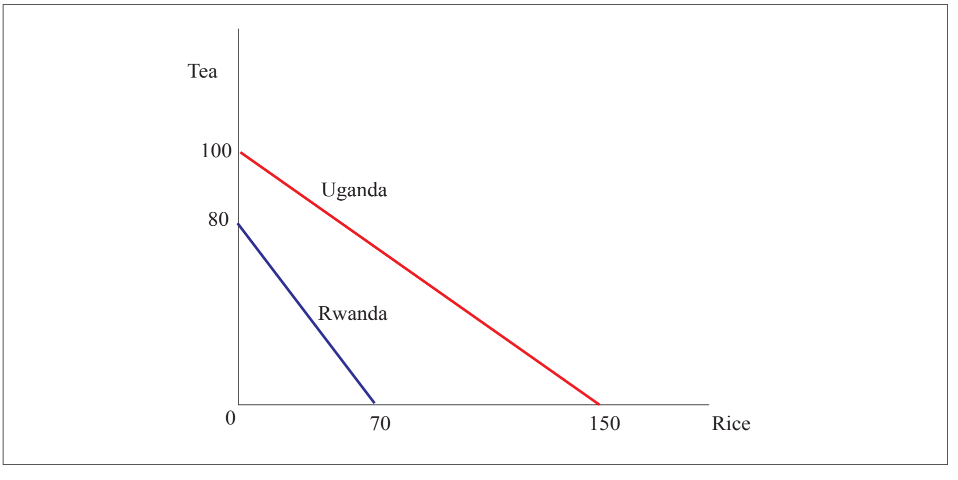
On the other hand, given equal quantity of resources, one country can produce both commodities better than another. Thus one country can have absolute advantage in production of both commodities than the other. This indicates a case of non-reciprocal absolute advantage.

Table 2: Non-reciprocal absolute advantage between Uganda and Rwanda production schedule.

Country	Tea (tons)	Rice (tons)
Rwanda	80	70
Uganda	100	150
World total	180	220

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

Figure 11: Absolute advantage between Uganda and Rwanda using a production possibilities curve.



From the above information in the table and graph, it can be seen that if Uganda decided to produce only tea, it would produce 100 tons and if it decided to produce only rice, it would produce only 150 tons. Similarly, if Rwanda decided to produce only tea, it would produce only 80 tons, and if it decided to produce only rice, it would produce 70 tons. Each country has several possible combinations of tea and rice it can produce as shown along the production possibilities curve.

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

1.7.2 The theory of comparative advantage

Activity 6

Based on the research on theories of international trade carried out in activity 5 above, analyse the case study below and answer the questions that follow.

Given the same conditions, Gicumbi farmers in Rwanda can produce 1000 tons of carrots and 2000 tons of oranges. While Kabale farmers in Uganda can produce 800 tons and 1500 tons of carrots and oranges respectively. If trade is to take place between the two groups of farmers in both countries, they must specialise so as to have effective exchange;

(d) Which theory of international trade is manifested in the case study above? Justify your answer.

(e) How will production be possible in both countries?

(f) Between the two farmers above, who should specialize in which commodity and why?

(g) What is the basis of specialization by the two farmers named above?

(h) To what extent is the theory applicable in real life experience?

Facts

Meaning of comparative advantage

The theory of comparative advantage was advanced by David Ricardo in 1817. It followed Adam Smith's theory of absolute advantage and said that even in the absence of absolute cost advantage, international trade was possible. He postulated that even where one country had an absolute advantage in the production of both commodities, both countries would benefit, if the first country concentrated only on the production of the most advantageous commodity, leaving the second country to produce the other commodity. Comparative advantage is the ability of a country to produce a commodity at a less opportunity cost than another.

Thus a country has a comparative advantage over the other when it incurs less opportunity cost than the other in the production of a given commodity.

The theory thus states that "Given 2 countries and 2 commodities, with a given amount of resources, a country should specialise in producing a commodity where it has a least opportunity cost compared to the other country". The specialising country would benefit from trade if it exchanges the surplus of its products for other products in which it has a higher opportunity cost.

Assumptions underlying comparative cost advantage

The theory of comparative cost advantage is based on the following assumptions:

- Labour is the only factor of production.
- All labour is homogeneous and freely transferable from one commodity to another.
- The cost ratios between two commodities remain constant.
- Trade takes place between two countries and in two commodities.
- There are no transport costs and no restrictions on trade.
- There is perfect mobility of the factors of production within a country and perfect immobility internationally.
- The theory assumes constant technology.
- Constant returns to scale.
- The exchange rates of the two countries remain the same.
- The two countries have a double coincidence of wants with barter system of trade.

- Tastes and preferences between the two countries don't change.
- There is full employment of factors of production.
- There is free trade between two countries.

Table 3: Example; production possibilities between Rwanda and Uganda

Country	Tea (tons)	Rice (tons)
Rwanda	8	60
Uganda	10	80
Total	18	140

Uganda has an absolute advantage in the production of both commodities, Tea and Rice over Rwanda. Uganda has the absolute advantage in Tea (5:4) and it has an absolute advantage in Rice (4:3). However, if we examine the domestic opportunity cost ratios, it is clear that each country has a relative or comparative advantage in the production of one commodity.

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

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

From the above example it can be calculated as;

(i) For Rwanda to produce tea they forego rice

$$\text{Thus} = \frac{\text{quantity of rice}}{\text{quantity of tea}} = \frac{60}{8} = 7.5$$

(ii) For Rwanda to produce Rice, they forego tea

$$\text{Thus} = \frac{\text{quantity of tea}}{\text{quantity of rice}} = \frac{8}{60} = 0.13$$

(iii) For Uganda to produce tea, they forego rice,

$$\text{Thus} = \frac{\text{quantity of rice}}{\text{quantity of tea}} = \frac{80}{10} = 8$$

(iv) For Uganda to produce rice they forego Tea,

$$\text{Thus} = \frac{\text{quantity of tea}}{\text{quantity of rice}} = \frac{10}{80} = 0.125$$

This can be tabulated as;

Table 4: Production schedule showing opportunity cost between Rwanda and Uganda

Country	Tea (tons)	Rice (tons)
Rwanda	7.5	0.133
Uganda	8	0.125

In Rwanda, the domestic opportunity cost ratio is such that only 7.5 tons of rice must be given up for each ton of tea produced. The opportunity cost of producing one ton of tea is 0.133 tons of rice. However, in Uganda, the domestic opportunity cost ratio is such that 8 tons of rice must be given up for each ton of tea produced. The opportunity cost of producing one ton of rice is 0.125 tons of tea.

Rwanda therefore has a comparative advantage in the production of tea since for each ton of tea that is produced fewer rice is sacrificed than in Uganda. Similarly, Uganda, has a comparative advantage in the production of rice, since, for each ton of rice that is produced; less tea is sacrificed than in Rwanda. For each ton of rice produced, Uganda must sacrifice 0.125 tons of tea, whereas in Rwanda, for each ton of tea, 7.5 tons of rice must be sacrificed. If now Uganda concentrates on rice and Rwanda on tea, then the two countries are bound to benefit assuming that the value of one ton of rice is the same as that of one ton of tea.

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

Table 5: Production after specialisation

Country	Tea (tons)	Rice (tons)
Rwanda	16	0
Uganda	0	160
World Total	16	160

The production of tea has reduced by 2 and the production of rice has increased by 20 tons. On the average, however, the two countries have benefited by 18 tons of rice in terms of value, assuming the price of 1 ton of tea is equal to that of 1 ton of rice. Therefore, using the theory of cooperative of tea is equal to that of 1 ton of rice.

Therefore, using the theory of comparative advantage, a country that specializes in their comparative advantage in free trade is able to realize higher output gains by exporting the good in which they enjoy a comparative advantage and importing the good in which they suffer a comparative disadvantage.

Relevance/applicability of the comparative cost advantage

- LDCs have tended to specialise in producing primary products where they have a least opportunity cost e.g. Rwanda exports raw materials.
- LDCs still have barter trade arrangements among themselves.
- LDCs use labour intensive technology while MDCs use capital intensive technology so the assumption of no change in technology is realistic.
- There is some degree of mobility of factors of production among LDCs especially labour.
- LDCs import manufactured commodities where they have a high opportunity cost.
- There are some cases of free trade among LDCs especially in economic integrations.

Criticisms/limitations of the comparative cost advantage

Though the theory of comparative advantage appears to explain the basis of choice for a country in terms of what to produce, what to export and import from others, it has been criticised by a number of writers on the following accounts:

Two-country and two-commodity model

The model deals only with the situation in which trade takes place between two countries and in two commodities. This is a hypothetical situation which does not exist in real life. We are aware of the fact that international trade takes place between more than two countries and in more than two commodities. The world of only two countries producing only two commodities is a very unrealistic assumption. The real world is made up of a large number of countries engaged in production of a wide range of commodities.

Differences in tastes

The theory assumes that people all over the world have similar tastes. But this is untrue. People belonging to different levels of income have different tastes. In addition, the tastes also change according to the growth of an economy and with the opening of world markets and development of trade relations.

Role of technology is neglected

The theory does not recognise the role of technological innovations in international trade. It's however known that technological changes help in decreasing the cost of goods and increasing their supply not only in inter-regional trade but also in international trade.

Assumption of complete specialisation

The theory rests upon the assumption that there is complete specialisation or division of labour. In the real world, complete specialisation is not possible. Let us take an example of two countries — one small and the other large in terms of total output. The small country can specialise in the production of one good, but the large country will have to produce both goods, because the small country can neither supply the full requirements of the larger country nor can it absorb the surplus output of the larger country. Another situation could be when the two commodities are not of comparable values i.e. one commodity is of high value and the other of a low value. The country producing a high value commodity can specialise but it will not be profitable for the country producing a low-value commodity to specialise.

Assumption of free trade is unrealistic

It is wrong to assume the existence of free world trade. Countries do not always trade freely with each other. History provides ample evidence of the fact that different countries have imposed different restrictions on the free movement of goods to other countries from time to time. There are political, social or strategic reasons why governments will not permit free trade. Tariffs, quotas, exchange controls and other restrictions are imposed on trade. These restrictions have certainly affected the volume and direction of imports and exports. The existence of such restrictions on trade clearly limits the scope for specialisation between countries.

No consideration for transport costs

In his theory, Ricardo has shown no consideration for transport costs, which play an important role in determining the profitability and pattern of international trade. However big the difference between the cost ratios of the two commodities entering into trade may be, if it is narrowed down by the high cost of transporting the commodities, trade may not occur. The existence of transport costs gives rise to another class of goods besides those entering into trade, known as ‘domestic goods’. Some writers have, therefore, suggested that the cost of production should include the transportation cost.

Perfect competition

The prevalence of perfect competition in international trade is also an unrealistic assumption. The conditions of perfect competition cannot be achieved in the real world.

Equal efficiency of all factor inputs

The assumption that all units of factors of production are equally efficient is too simplistic. It is very difficult to find factors of production, which are equally efficient.

Perfect factor mobility

The theory assumes that countries can shift resources from the production of one good to the production of another good. In practice, there is likely to be a certain amount of factor immobility, which prevents this, especially in the short run.

Assumption of constant costs

The theory assumes the operation of the law of constant costs or returns. The assumption is entirely unrealistic. In practice, the usual rule in the production of goods is the operation of the law of increasing costs or diminishing returns, that is, beyond a certain point additional output can be obtained only at an increasing per unit cost. When the production takes place under the operation of this law, the cost ratios in both countries will not remain constant.

Coincidence of needs

The theory assumes coincidence needs. e.g. Uganda must want Rwanda’s tea, and Rwanda must want Uganda’s rice. This, however, may not be true in reality. For one reason or another, the cheapest source may not appeal to the customer country such that the customer prefers to buy from an expensive source. It should also be noted that two different currencies are used. However, the theory mentions nothing about them.

Equal costs in the countries

It is possible that the two countries may incur the same cost in the production of a certain commodity. In such a case, it is hard to find which country should specialise in a particular commodity.

Eternal poverty

The principle of comparative advantage has been criticised by LDCs on the grounds that if adhered to, it would perpetually commit them to being producers of raw materials. This might condemn them to eternal poverty. The present international economic structure is divided into the rich and the poor nations. The rich nations are the industrialised ones while the poor ones are the producers of primary products. The poor nations therefore believe that if they are to escape from the vicious cycle of poverty, they must industrialise. Unfortunately, the theory of comparative advantage places their advantage in the production of primary products which are faced with low prices and unfavourable terms of trade. MDCs have a comparative advantage in the production of manufactured goods which are faced with high prices and favourable terms of trade. This therefore implies that LDCs will forever remain poor.

Benefits of comparative cost advantage

- It encourages competition and improvement in efficiency. This reduces costs of production.
- It encourages specialisation and exchange.
- It increases global output of commodities.
- It encourages economic cooperation and free trade among countries.
- It encourages mass production and reaping of economies of scale.
- It discourages duplication of industries i.e. setting up of industries which already exist in other countries.
- It widens market for exports.
- It enables countries to get commodities which they cannot produce.
- It enables countries to get foreign exchange.
- Specialisation results into effective utilisation of resources some of which would be idle.

Factors that determine comparative advantage

Comparative Advantage is when a country may produce goods at a lower opportunity cost, but not necessarily have an absolute advantage in producing that good. This simply means that a country can produce a good at a lower cost than another country. Having a comparative advantage is not the same as being the best at something. In fact, someone can be completely unskilled at doing something, yet still have a comparative advantage at doing it! Comparative advantage is a dynamic concept meaning that it changes over time. Comparative advantage is what actually determines whether it pays to produce a good or import it. For a country, some of the factors below are important in determining the relative unit costs of production:

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

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

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

- **Market levels:** Rising demand/market helps countries to encourage specialisation, higher productivity and internal and external economies of scale. These long-run scale economies give regions and countries a significant unit cost advantage than those countries with less demand or market for their commodities.
- **Investment in research & development** which can drive innovation and invention. A country that invests much in research and development, promotes mushrooming production techniques hence giving a greater comparative advantage than another which doesn't.
- **Foreign exchange rate stability:** Fluctuations in the exchange rate affect the relative prices of exports and imports and cause changes in demand from domestic and overseas customers hence putting such affected countries at a less comparative advantage than another whose exchange rate is stable for long period of time.
- **Import controls such as tariffs, export subsidies and quotas** – these can be used to create an artificial comparative advantage for a country's domestic producers.
- **Non-price competitiveness of producers** - covering factors such as the standard of product design and innovation, product reliability, quality of after-sales support. These help a country to win market for their commodities hence giving such countries products a comparative advantage than others. Many countries are now building comparative advantage in high-knowledge industries and specializing in specific knowledge.
- **Institutions:** Availability of institutions that facilitate production are important for comparative advantage and for growth of a given country. E.g. banking systems needed to provide capital for investment and export credits, legal systems that help to enforce contracts, political institutions and the stability of democracy is a key factor behind decisions about where international capital flows. These institutions provide a strong milestone to a country's production capacity hence its comparative advantage than another which has weak or non-existent institutions.

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

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

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

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

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

- **Factor Abundance:** Goods differ in terms of the resources, or factors inputs, required for their production. Countries differ in terms of the abundance of different factors of production: land, labour, capital and entrepreneurial ability. So, it is quite obvious that countries would have an advantage in producing those goods that use relatively large amounts of their most abundant factor of production. Certainly, countries with a relatively large amount of farmland e.g. developing countries, would have a comparative advantage in agriculture, and countries with a relatively large amount of capital i.e. developed countries, would tend to specialise in the production of manufactured goods. Or Countries with a huge supply of relatively cheap labour would specialise in labour-intensive products and countries with abundant capital would specialise in the production of capital-intensive products.

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

- **Product Life Cycles:** The product-life-cycle theory is related to international comparative advantage in that a new product will be the first produced and exported by the nation in which it was invented. As the product is exported elsewhere and foreign firms become familiar with it, the technology is copied in other countries by foreign firms seeking to produce a competing version. As the product matures, comparative advantage shifts away from the country of origin, if other countries have lower manufacturing costs for using the now-standardised technology. For example, the history of colour-television production shows how comparative advantage can shift over the product life cycle. It was invented in the US, and US firms initially produced and exported them. Over time, as the technology manufacturing them became well-known, countries like Japan and Taiwan came to dominate the business and had a comparative advantage over US firms in the manufacture of colour TVs. Once the technology is widely available, countries with cheaper assembly lines, due to lower wages, can compete effectively against the higher-wage nation that developed the technology.

Unit assessment

1. (a) State the principle of comparative advantage as used in international trade.

   (b) Study the figure below and answer the question that follows

Country	Resources	Maize (tons)	Sugar (tons)
Rwanda	5000	20,000	15,000
Tanzania	5000	15,000	5,000

   Calculate the comparative advantage of the two countries and state the commodity that the two countries should concentrate on production.

2. Why do we buy goods from abroad if we can make them locally?
3. (a) Explain the contribution of international trade to the economic development of your country.

   (b) Why do most LDCs today benefit little from international trade?
4. (a) Distinguish between comparative advantage and absolute advantage.

   (b) "The principle of comparative advantage is an outmoded concept,". do you agree?

   (c) Discuss the view that where there is not comparative advantage there is nothing to gain from international trade.
5. Consider the view that gains from international trade are biased in favour of advanced industrial countries.

Glossary

- **Absolute advantage**: The ability of a country to produce a good or a service at a lower cost per unit than the cost another produces the same good or service.
- **Bi-lateral trade**: Trade between two countries.
- **Comparative advantage**: The basis of trade between nations where opportunity cost of producing the good is lower than the opportunity cost of producing the same good or service in other trading nations.
- **Exports**: Goods/services produced within a country and sold to other countries.
- **Export incentives**: Favourable conditions put in place to boost exports of a country.
- **Export potential**: The amount of unused resources in a country that can be exploited for the external market e.g. forest, mineral etc.
- **Imports**: Imports are goods/services which are produced in other countries and brought into one country.
- **Import surplus**: A situation that exists when the value of imports exceeds that of imports (unfavourable trade balance).
- **Individualism**: This is a belief that individuals are the best judges of their own interests.
- **Invisible commodities**: Items that are not tangible and these are services e.g. insurance, tourist expenditures etc.
- **Invisible trade**: Trade in services e.g. tourism, education, banking etc.
- **Multi-lateral trade**: Trade among several countries.
- **Trade gap**: This occurs when the quantity of imported goods exceeds that of visible exports. It is the amount by which visible imports exceed visible exports.

- **Unrequited exports**: These are exports that do not earn any foreign exchange. Such exports arise out of a debt owed by a country to another. i.e. used to pay off the debt.
- **Vent-for-surplus**: This explains the view that exploitation of idle domestic resources for exports can lead to national income.
- **Visible trade**: Trade in goods.

Unit summary

- International trade
    - Meaning
    - Forms, and terminologies used
    - Advantages, disadvantages and limitations
- Theories of international trade
    - Absolute advantage
    - Comparative advantage

Topic Area 4: International Economics

Sub-Topic Area 4.1: International Trade

UNIT 2 Terms of Trade

Key unit competence: Learners will be able to describe the terms of trade in LDCs.

My goals

By the end of this unit, I will be able to:

- Differentiate between income and barter terms of trade.
- Describe the nature of terms of trade in LDCs.
- Identify factors for improving terms of trade in LDCs.
- Demonstrate the terms of trade and balance of trade in LDCs through calculations and make interpretation.
- Analyse the ways of improving terms of trade in LDCs.
- Assess the causes and consequences of changes in terms of trade.
- Take part in improving terms of trade in LDCs/Rwanda.

2.1 Meaning of Terms of Trade

Activity 1

Using the case study below, visit the library, the internet or any other economics source and research about terms of trade. Using the gained knowledge, share and discuss as a class the questions that follow.

In 2015, Rwanda exported her coffee to Japan and in turn imported cars from there. The price of coffee per ton was 800 dollars while that of a car was 1,700 dollars. The following year i.e. 2016, coffee prices in the world market fell by 20% while that of cars remained constant.

(a) What economic term do we call the relationship between Rwanda's export prices and import prices?

(b) Calculate the terms of trade for Rwanda in 2015 and 2016 respectively.

(c) Describe the nature of terms of trade of Rwanda in 2015 and 2016 respectively. Support your answer.

(d) How can terms of trade be expressed?

Facts

Terms of trade (TOT) refers to the relative price of exports in terms of imports. It is the ratio of export prices to import prices. It can be interpreted as the amount of import goods an economy can purchase per unit of export goods, i.e. import purchasing power of exports. For example, if an economy is only exporting coffee and only importing cars, then the terms of trade are simply the price of coffee over the price of cars. In other words, how many cars can you get for a unit of coffee? Since economies typically export and import many goods, measuring the terms of trade requires defining price indices for exported and imported goods and comparing the two.

A rise in the prices of exported goods in international markets would increase the terms of trade, while a rise in the prices of imported goods would decrease the terms of trade. For example, countries that export oil will see an increase in their terms of trade when oil prices go up, while the terms of trade of countries that import oil would decrease.

An improvement of a nation's terms of trade benefits that country in the sense that it can buy more imports for any given level of exports. The terms of trade may be influenced by the exchange rate because a rise in the value of a country's currency lowers the domestic prices of its imports but may not directly affect the prices of the commodities it exports.

Terms of trade is the ratio of a country's export price index to its import price index, multiplied by 100. The terms of trade measure the rate of exchange of one good or service for another when two countries trade with each other.

Terms of trade can be expressed as;

$$\text{TOT} = \frac{\text{Average price index of exports}}{\text{Average price index of imports}} \quad \text{or}$$

$$\text{TOT} = \frac{\text{Px}}{\text{Pm}} \times 100$$

Where; PX = average price index for exports, PM = average price index for imports

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

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

2.2 Forms of Terms of Trade

Terms of trade are categorised into two, namely;

1. Barter/commodity terms of trade
2. Income/monetary terms of trade

a) Barter/commodity terms of trade

Barter / commodity terms of trade is the relationship between export prices and import prices, i.e. the ratio of average price index of exports to the average price index of imports. Symbolically, it can be expressed as:

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

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

Taking 2012 as the base year and expressing Rwanda's both export prices and import prices as 100, if we find that by the end of 2015 its index of export prices had fallen to 80 and the index of import prices had risen to 120. The terms of trade had changed as follows:

$$\text{Barter TOT} = \frac{Px}{Pm} \times 100 = \frac{80}{120} \times 100 = 66.67$$

It implies that Rwanda's terms of trade declined by about 33.33 per cent in 2015 as compared to 2012, thereby showing worsening of its terms of trade.

If the index of export prices had risen to 150 and that of import prices to 130, then the terms of trade would be;

$$= \frac{Px}{Pm} \times 100 = \frac{150}{130} \times 100 = 115.2.$$

This implies an improvement in the terms of trade by 15.2 per cent in 2015 over 2012.

Limitations of barter terms of trade

Despite its use as a device for measuring the direction of movement of the gains from trade, this concept has important limitations.

1. Problems of index numbers

Usual problems associated with index numbers in terms of coverage, base year and method of calculation arise.

2. Change in quality of product

The commodity terms of trade are based on the index numbers of export and import prices. But they do not take into account the changes taking place in the quality and composition of goods entering into trade between two countries. At best, commodity terms of trade index show changes in the relative prices of goods exported and imported in the base year. Thus the net barter terms of trade fail to account for big changes in the quality of goods that are taking place in the world, as also new goods that are constantly entering in international trade.

3. Problem of selection of period

The problem arises in selecting the period over which the terms of trade are studied and compared. If the period is too short, no meaningful change may be found between the base date and the present. On the other hand, if the period is too long, the structure of the country's trade might have changed and the export and import commodity content may not be comparable between the two dates.

4. Cases of changes in prices

Another serious difficulty in the commodity terms of trade is that it simply shows changes in export and import prices and not how such prices change. As a matter of fact, there is much qualitative difference when a change in the commodity terms of trade index is caused by a change in export prices relative to import prices as a result of changes in demand for exports abroad, and ways or productivity at home. For instance, the commodity terms of trade index may change by a rise in export prices relative to import prices due to strong demand for exports abroad and wage inflation at home. The commodity terms of trade index do not take into account the effects of such factors.

5. Neglect of import capacity

The concept of the commodity terms of trade throws no light on the country's "capacity to import". Suppose there is a fall in the commodity terms of trade in Rwanda, it means that a given quantity of Rwandan exports will buy a smaller quantity of imports than before.

Along with this trend, the volume of Rwandan exports also rises may be as a consequence of the fall in the prices of exports. Operating simultaneously, these two trends may keep Rwanda's capacity to import unchanged or even improved. Thus the commodity terms of trade fails to take into account a country's capacity to import.

6. Ignores productive capacity

The commodity terms of trade also ignore a change in the productive efficiency of a country. Suppose the productive efficiency of a country increases, it will lead to a fall in the cost of production and in the prices of its export goods.

The fall in the prices of export goods will be reflected in the worsening of its commodity terms of trade. But, in reality, the country will not be worse off than before. Even though a given value of exports will exchange for less imports, the country will be better off. This is because a given volume of exports can now be produced with lesser resources, and the real cost of imports, in terms of resources used in exports, remains unchanged.

7. Not helpful in Balance of Payment disequilibrium

The concept of commodity terms of trade is valid if the balance of payments of a country includes only the export and imports of goods and services, and the balance of payments balances in the base and the given years. If the balance of payments also includes unilateral payments or unrequired exports and or/imports, such as gifts, remittances from and to the other country, etc., leading to disequilibrium in the balance of payments, the commodity terms of trade is not helpful in measuring the gains from trade.

8. Ignores gains from Trade

The concept of commodity terms of trade fails to explain the distribution of gains from trade between a developed and under-developed country. If the export price index of an underdeveloped country rises more than its import price index, it means an improvement in its terms of trade. But if there is an equivalent rise in profits of foreign investments, there may not be any gain from trade.

b) Income/monetary terms of trade

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

It can be expressed as;

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

Example 1

1. Taking 2010 as a base year and expressing Rwanda's both export prices and import prices. As 100, if in 2015 the price of exports (PX) is 140, price of imports (PM) is 70 and quantity of exports is 80 then income terms of trade is;

$$= \frac{Px.Qx}{Pm} = \frac{140\times80}{70} = 160$$

It implies that there is improvement in the income terms of trade by 60 per cent in 2015 as compared to 2010.

Example 2

2. taking 2010 as base year again and expressing Rwanda's both export prices and import prices as 100. If in 2015 Price of exports = 80, Price of imports =160 and Quantity of exports =120, then

$$\text{Income TOT} = \frac{Px\times Qx}{Pm} = 80 \text{ x } \frac{120}{160} = 160$$

It implies that the income terms of trade have deteriorated by 40 per cent in 2015 as compared to 2010.

A rise in the index of income terms of trade implies that a country can import more goods in exchange for its exports. A country's income terms of trade may improve but its commodity terms of trade may deteriorate. Taking the import prices to be constant, if export prices fall, there will be an increase in the sales and value of exports. Thus while the income terms of trade might have improved, the commodity terms of trade might have deteriorated.

The income terms of trade is called the capacity to import. In the long-run, the total value of exports of a country must be equal to its total value of imports. Thus determine which is the total volume that a country can import. The capacity of a country to import may increase, other things remaining the same if;

(i) the price of exports rises,
(ii) the price of imports falls,
(iii) the volume of its exports rises.

Thus the concept of the income terms of trade is of much practical value for developing countries having low capacity to import.

Criticisms of income terms of trade

The concept of income terms of trade has been criticised on the following counts:

1. Fails to measure gain or loss from trade

The index of income terms of trade fails to measure precisely the gain or loss from international trade. When the country's capacity to import increases, it simply means that it is also exporting more than before. In fact, exports include the real resources of a country which can be used domestically to improve the standards of living of its people.

2. Not related to total capacity to import

The income terms of trade index is related to the export based capacity to import and not to the country's total capacity to import which also includes its foreign exchange receipts. For example, if the income terms of trade index of a country have deteriorated but its foreign exchange receipts have risen, its capacity to import has actually increased, even though the index shows deterioration.

3. Inferior to commodity terms of trade

Since the index of income terms of trade is based on commodity terms of trade and leads to contradictory results, the concept of the commodity terms of trade is usually used in preference to the income terms of trade concept for measuring the gain from international trade.

2.2.1 Limitations of terms of trade

- Terms of trade should not be used synonymously with social welfare, or even Pareto economic welfare. Terms of trade calculations do not tell us about the volume of the countries' exports, only relative changes between countries. To understand how a country's social utility changes, it is necessary to consider changes in the volume of trade, changes in productivity and resource allocation, and changes in capital flows.

- The price of exports from a country can be largely influenced by the value of its currency, which can in turn be largely influenced by the interest rate in that country.

  If the value of currency of a particular country is increased due to an increase in interest rate, one can expect the terms of trade to improve.

  However, this may not necessarily mean an improved standard of living for the country since an increase in the price of exports perceived by other nations will result in a lower volume of exports. As a result, exporters in the country may actually be struggling to sell their goods in the international market even though they are enjoying a (supposedly) high price.
- In the real world of over 200 nations trading hundreds of thousands of products, terms of trade calculations can get very complex. Thus, the possibility of errors is significant.

2.3 Nature of Terms of Trade for LDCs

Activity 2

Developing countries are always interested in the trend in export and import prices and also more concerned about the trends in their export earnings and import payments. This is because these trends in turn determine the long-term trend in the balance of payments on current account and indicate whether future balance-of-payments difficulties are likely to arise. https://link.springer.com

a) From the extract above, why do developing countries mind about keeping track of the trend of export and import prices?

b) Basing on the extract above, carry out research to identify and describe the trend of export and import prices for developing countries.

c) What causes the trend mentioned above for developing countries?

Suggest possible measures that developing countries should undertake to streamline its export import price relationship.

Facts

Most LDCs have unfavourable and deteriorating terms of trade. The following are the main reasons for unfavorable and declining terms of trade of less developed countries:

2.3.1 Causes of deteriorating terms of trade in LDCs

Nature of product

The less developed countries are mainly primary producing countries. Their exports mostly include primary products and their imports include capital goods. On the contrary, the developed countries produce and export manufactured goods. Thus the terms of trade between the primary products and manufactured products are generally determined against the former and in favour of the latter.

Effect of technical progress

Industrial countries keep the whole benefit of their technical progress, whereas the primary producing countries transfer a part of the fruits from their own technical progress to the industrial nations. Money incomes and prices have risen more rapidly than productivity in industrial countries, whereas in the primary producing countries, the gains in productivity have been distributed in the form of price reductions. This has led to the deterioration of terms of trade of the primary producing countries.

Different market conditions

Export prices in the industrial countries do not fall as a result of technical progress because the manufacturers operate under monopolistic conditions in the product market; and they do not operate under competitive conditions in the factor market, i.e., labour market is dominated by trade unions. Thus, the benefit of the improved technology is not transferred to the consumers in poor countries.

The producers in the poor countries, on the other hand operate under competitive conditions both domestically and internationally. Thus, as a result of technical progress in these countries, prices fall and the benefits flow to the consumers in the rich countries.

Price movements through business cycles

The prices of primary products rise sharply in the prosperous periods and fall in the downswing of the business cycle.

In contrast, although manufacturing prices rise in the upswing of the cycle, these do not fall so much in the depression because of the rigidity of industrial wages and price inflexibility due to monopolistic conditions.

Thus, over successive cycles, the gap between the prices of the two groups of commodities has widened, and the primary producing countries have suffered an unfavourable movement in their terms of trade.

Disparity in demand

Declining terms of trade of the less developed countries is also due to long-term disparity in the demand for manufactured and primary products.

In the industrial countries, the income elasticity of demand for primary products is inelastic (i.e., less than one), while in the poor countries, the income elasticity of demand for manufactured goods is more elastic (exceeds one).

This is because, as incomes rise, the proportion of expenditure on food declines. Thus, the demand for food increases less rapidly than the rise in income and the demand for raw materials is restricted by competition from synthetic or man-made substitutes.

Backward technology

The less developed countries use backward technology as compared to the developed countries. As a result, their relative productivity is low, cost ratios are high, and price structure is also relatively high. This leads to the adverse terms of trade for the poor country, placing it at a disadvantageous bargaining position.

High population growth

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

Lack of import substitutes

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

High transport costs

Rwanda being a land locked country and without cheap air or railway links to regional or international markets make it difficult for trade development in the country.

Lack of adaptability

Unlike, the advanced countries, the less developed countries cannot quickly adapt their supply of goods which are high in demand and whose prices are rising. The reasons for this are: backward technology, market imperfections, immobility of factors of production, etc.
Thus, the terms of trade of less developed countries tend to deteriorate and these countries fail to reap gains by increasing their supplies of exports during inflation.

Similarity of products

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

Political instability

Most LDCs lack a considerable manufacturing sector as a result of political instability and insecurities. This reduces the volume of manufactured commodities that would be exported.

Lack of diversification in production in LDCs

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

2.3.2 How to improve terms of trade for LDCs

Most LDCs face unfavourable terms of trade, an indication that LDCs do not favourably enjoy the benefits of international trade. LDCs should adopt any of the following policies in order to improve their terms of trade so as to enjoy more benefits from international trade.

Carry out adequate market research

LDCs should carry out market research so as get enough information to widen markets for their commodities. For example in Rwanda, the opportunity of having research institutions e.g. ISSAR, KIST, IRST have done a number of researches in Agriculture and Scientific technology. Many of these researches are market oriented and enables us to access new clients and overcome supply constraints domestically, regionally and internationally.

Human resource development

LDCs should develop a strong human resource through education and training so as to reduce expenditure on imported labourforce which is always expensive. For example, availability of skilled and semi-skilled labour in the country allows different types of people to be employed in many of the existing sectors and then lead to economic development.

Promote peace and security

Due to instabilities in most LDCs, there is always fear by investors both local and foreign, therefore LDCs should ensure peace and security in all parts of their countries, for example, the prevailing peace and security in Rwanda presents a strong opportunity for trade development as the business men carry out their activities without fear of robbery or any other security risk.

Good governance

In most LDCs, there is financial indiscipline like corruption and embezzlement of government funds which normally affects productive sectors thus less productive capacity. In LDCs economies, trade is favoured by the existence of good governance, for example in Rwanda, especially with the establishment of ombudsman, it has helped in fighting against corruption in all sectors which has promoted transparency and efficiency thus increased gains from trade.

Promoting regional integration and economic cooperation among LDCs

LDCs should form economic groupings and trade among themselves in order to avoid exploitation by MDCs. For example, Rwanda is already a member to regional and international bodies like East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA) and its free trade area and is able to access the whole market without any barriers to trade. Rwanda is also ready to benefit from various blocks like Economic Community for Central African States (ECCAS), African Growth Opportunity Act (AGOA), African Union (AU), World Trade Organisation (WTO), European Union (EU), bilateral trade arrangements, etc. This offers Rwanda an opportunity for easy access to foreign markets.

Public - Private sector partnership

LDCs should promote the development of private sector so as to promote efficiency in production and increase the exploitation of idle resources which increases export volume. The government's commitment to private sector development makes it an opportunity for trade development, as there are initiatives of creating conducive environment for trade thus increasing gains from international trade.

Legal task force

Different countries have different laws governing trade/business in their economies; this however limits opportunities to investment and trade. Therefore, there should be an effort made on the establishment of business legal reform task force mandated to reform all business laws; this will create conducive legal environment for trade by both local and foreign investors and will increase the gains form international trade among LDCs.

Financial task force

There should be establishment of financial sector task force with the mandate of solving all problems in the financial sector. This helps avail easy and cheap credit facilities to potential investors and business class which boosts their productive levels thus increasing the export base.

Trade point

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

Permanent trade fair ground

LDCs should enhance the establishment of permanent national and international trade fair grounds which creates an opportunity for trade development as it will give business men a chance of regular expositions which will help them in the sell and advertisements of their products.

Business Development Centres (BDS)

Business development centres (BDS) should be established. This will facilitate easy coordination of business activities in rural areas.

Export processing zone

Establishment of export processing zone which facilitate trade development in particular and development in general. This helps transform LDCs commodities into finished products so as to increase the export value and gains from trade as well.

Producer cooperatives and associations

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

Population control measures

LDCs should take up strong measures to control population growth e.g through family planning campaigns. Population control can increase on the level of exports.

Diversification of domestic production

LDCs should diversify their production so as to reduce dependency on few traditional exports where terms of trade are unfavourable and keep on fluctuating.

Import substitution strategy

LDCs should adopt import substitution strategy so as to minimise import expenditure.

Technological development

There should be the development and use of intermediate technology to reduce expenditure on expensive capital.

2.4 Balance of Trade

Activity 3

Using the knowledge gained from unit 1, visit the library, the internet or any other economic resource, undertake research about balance of trade, discuss and share among yourselves about the following;

(a) What economic term is given to the difference between export and import of goods in a country?

(b) What economic term is given to the difference between export and import of services in a country?

(c) When is the balance of trade of a country said to be favorable and or unfavorable?

(d) What distinguishes balance of trade from balance of payment?

Facts

2.4.1 Meaning of Balance of Trade

Balance of Trade (BOT) is the difference in value over a period of time between a country's imports and exports in tangible or visible commodities, usually expressed in the unit of currency of a particular country. The balance of trade denotes the difference of imports and exports of a merchandise of a country during the course of a year. The trade balance is identical to the difference between a country's output and its domestic demand (the difference between what goods a country produces and how many goods it buys from abroad; this does not include money re-spent on foreign stock, nor does it factor in the concept of importing goods to produce for the domestic market).

The balance of trade is part of a larger economic unit, the balance of payments (the sum total of all economic transactions between one country and its trading partners around the world), which includes capital movements (money flowing to a country paying high interest rates of return), loan repayment, expenditures by tourists, freight and insurance charges, and other payments.

If the value of exports of a country over a period exceeds its value of imports, the country is said to have a favourable balance of trade, or a trade surplus. Conversely, if the value of total imports exceeds total value of its exports over a period, an unfavourable balance of trade, or a trade deficit, exists. A favourable balance of trade indicates good economic condition of a country.

A continuing surplus may, in fact, represent underutilised resources that could otherwise be contributing towards a country's wealth, where they are to be directed toward the purchase or production of goods or services. Furthermore, a surplus accumulated by a country (or group of countries) may have the potential of producing sudden and uneven changes in the economies of those countries in which the surplus is eventually spent.

Generally, the developing countries (unless they have a monopoly on a vital commodity) have particular difficulty maintaining surpluses since the terms of trade during periods of recession work against them; that is, they have to pay relatively higher prices for the finished goods they import but receive relatively lower prices for their exports of raw materials or unfinished goods.

The balance of trade forms part of current account on the BOP, which includes other transactions such as income from the net international investment position as well as international aid. If the current account is in surplus, the country's international asset position increases correspondingly. Equally, a deficit decreases the country's international asset position.

Table 1: Difference between Balance of Trade and Balance of Payments

Balance of Trade	Balance of Payment
Balance of Trade includes only visible imports and exports, i.e. imports and exports of merchandise, the difference of imports and exports is called Balance of Trade. If imports are more than exports, it is unfavourable balance of trade. If exports exceed imports, it is favourable balance of trade.	Balance of Payments include all those visible and invisible items exported from and imported into the country in addition to exports and imports of merchandise.
Balance of Trade includes revenues received or paid on account of imports and exports of merchandise. It shows only revenue items.	Balance of Payments includes all revenue and capital items whether visible or non-visible. Balance of Trade thus forms a part of Balance of Payments.
Balance of Trade can be favourable or unfavourable. If imports are more than exports, it is unfavourable balance of trade. If exports exceed imports, it is favourable balance of trade.	Balance of Payments is always balanced just like Trading and Profit and Loss A/c of a business
In case of Balance of Trade, there is no deficit or surplus balance. The balance shows favourable or non-favourable. So, external assistance is not required.	In case of Balance of Payments, any balance, deficit or surplus is to be financed by external source or assistance or be utilised.

2.4.2 Factors that can affect the balance of trade

- The cost of production (land, labour, capital, taxes, incentives, etc.) in the exporting economy vis-à-vis those in the importing economy.
- The cost and availability of raw materials, intermediate goods and other inputs.
- Exchange rate movements.
- Non- tariff barriers such as environmental health or safety standards.
- The availability of adequate foreign exchange with which to pay for imports.
- Prices of goods manufactured at home (influenced by responsiveness of supply).
- Multilateral, bilateral and unilateral taxes or restrictions in trade.

2.4.3 **Rwanda's balance of trade**

External balance on goods and services (formerly resource balance) equals exports of goods and services minus imports of goods and services (previously nonfactor services). Data are in current U.S. dollars.

Rwanda trade balance for 2019 was $-1.58B, a 45.46% increase from 2018.

Rwanda trade balance for 2018 was $-1.09B, a 5.38% decline from 2017.

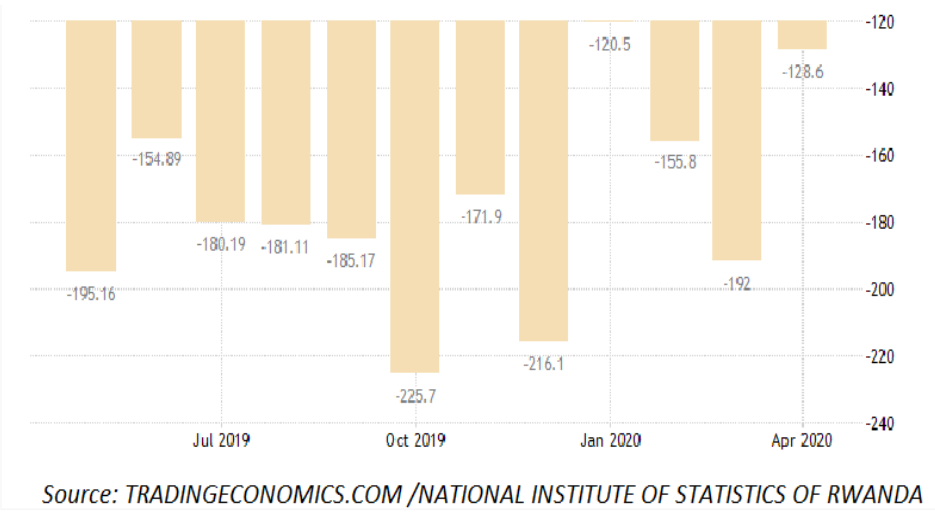
Rwanda trade balance for 2017 was $-1.15B, a 35.69% increase from 2016.

Rwanda trade balance for 2016 was $-0.85B, a 1.86% decline from 2015.

Source: https://www.macrotrends.net/countries/RWA/rwanda/trade-balance-deficit

The deficit in the balance of formal trade in goods was US$ 128.60 million in April 2020, a decrease of 33.00 per cent compared to the previous month of March. Year-over-year, the formal trade in goods deficit decreased by 4.43 per cent on the deficit of April 2019. The deficit in the balance of formal trade in goods was US$ 132.02 million in May 2020, an increase of 2.66 per cent compared to the previous month of April. Year-over-year, the formal trade in goods deficit decreased by 42.66 per cent compared to May 2019.

Figure 1: Rwanda balance of trade 2019-2020



Source: www.tradingeconomics.com/NationalbankofRwanda.

Actual	Previous	Highest	Lowest	Dates	Unit	Frequency
-128.60	-192.00	-100.59	-1268.30	1998 - 2020	USD Million	Monthly

Rwanda Trade	Last	Previous	Highest	Lowest	Unit	
Balance of Trade	-128.60	-192.00	-100.59	-1268.30	USD Million	[+]
Current Account	-736.50	-699.10	99.12	-1352.50	USD Million	[+]
Current Account to GDP	-7.80	-7.70	1.80	-15.90	percent	[+]
Imports	201.60	299.58	1859.00	156.90	USD Million	[+]
Exports	73.00	107.63	590.80	37.16	USD Million	[+]
Capital Flows	-460.60	-396.60	426.80	-814.60	USD Million	[+]
Terrorism Index	2.95	2.18	3.94	0.42		[+]
Foreign Direct Investment	305.50	270.70	314.70	118.67	USD Million	[+]
External Debt	3010.00	2453.00	3010.00	511.20	USD Million	[+]

Rwanda's exports remained dominated by traditional products such as coffee, tea and minerals like tin, coltan, wolfram and cassiterite. Rwanda's main exports partners are China, Germany and United States. Rwanda imports mainly food products, machinery and equipment, construction materials, petroleum products and fertilizers. Main imports partners are Kenya, Germany, Uganda and Belgium..

2.4.4 Calculations of balance of trade

Table 2: Balance of trade 2014- 2015

Items /year	2014 (in million francs)	2015 (in million francs)
EXPORTS		
Goods	100	50
Services	50	180
IMPORTS		
Goods	90	120
Services	150	100
TRANSFERS		
To the other country	5	20
From the other country	10	10

CAPITAL FLOWS		
Inflows	20	350
Outflows	30	40
MONETARY/CASH ACCOUNT	M	N

(a) Calculate visible balance for both years and interpret the answer.

(b) Calculate invisible balance for both years.

(c) Calculate the net capital inflows for both years.

(d) Determine the net transfers.

(e) Calculate the current balance.

(f) Assuming there are no errors and omissions, what is the balance on monetary account in both years (M and N).

Answers

(a) Visible balance = Value of exported goods minus value of imported goods

For 2014 = 100,000,000 − 90,000,000
=10,000,000 FRW

For 2015 = 50,000,000 − 120,000,000
= -70,000,000 FRW

In 2014 the country enjoyed favourable trade balance

In 2015 the country experienced unfavourable (adverse) visible trade balance

(b) Invisible balance= value of exported services minus value of imported service.

services

For 2014 = 50,000,000 − 150,000,000
= -100,000,000 FRW

For 2015 = 180,000,000 − 100,000,000
= 80,000,000 FRW

In 2014 the country imported more services than it exported thus experiencing unfavourable invisible balance.

In 2015 the country exported more services than it imported Thus experiencing unfavourable invisible balance.

(c) Net capital inflow (BOP on capital account) = Capital inflow-capital outflow

For 2014 = 20,000,000 − 30,000,000
= -10,000,000 FRW

For 2015 = 350,000,000 − 40,000,000
= 310,000,000 FRW

(d) Net transfers = transfers into the country – transfers out of the country

For 2014 = 10,000,000 – 5,000,000
= 5,000,000 FRW

For 2015 = 10,000,000 −20,000,000
= -10,000,000 FRW

(e) Current balance = visible balance + invisible balance + net transfers

For 2014 =10,000,000 + -100,000,000 + 5,000,000
= -85,000,000 FRW

For 2015 = -70,000,000 + 80,000,000 + -10,000,000
= 0 FRW

(f) Balance on monetary account
= ***visible balance + invisible balance + net transfers +balance on capital*** account
= current balance + balance on current account

For 2014 = -85,000,000 + -100,000,000
= -95,000,000 FRW

For 2015 = -70,000,000 + 80,000,000 + -10,000,000 + 310,000,000
= 0 + 310,000,000
= 310,000,000 FRW

Exercise

Table 3: Study the table below and answer the questions that follow;

Item/year	2014 (in million francs)	2016 (in million francs)
EXPORTS		
Goods	200	100
Services	100	250
IMPORTS		
Goods	150	200
Services	250	100
TRANSFERS		
To the other country	10	30
From the other country	20	15
CAPITAL FLOWS		
Inflows	40	400
Outflows	50	60
MONETARY/CASH ACCOUNT	A	B

(a) Calculate visible balance for both years and interpret the answer.
(b) Calculate invisible balance for both years.
(c) Calculate the net capital inflows for both years.
(d) Determine the net transfers.
(e) Calculate the current balance.
(f) Assuming there are no errors and omissions, calculate the balance on monetary account in both years (A and B) and interpret your results.

2.4.5 Causes of changes in the terms of trade

Activity 4

Think of a situation where a country's terms of trade in some years are favourable and unfavourable in others, from the knowledge acquired on terms of trade in Activity 1 and 2 of unit 2, share your views in your class discussions about:

(a) The possible causes of changes in the terms of trade for LDCs.

(b) The resultant consequences of changes in the terms of trade on balance of trade.

Facts

Causes of changes in terms of trade in the short run and long-run include:

(a) Short-run

The terms of trade is the price relationship between a country's exports and imports and will, therefore, be influenced by all the factors which determine the prices of imports and exports.

Fluctuations in exchange rates

In the short-run, changes in relative prices of imports and exports will be caused by fluctuations in exchange rates, particularly where countries operate a floating exchange rate system. Exchange rate instability may be caused by changes in trade, capital flows, interest rates, speculation, inflation and use of foreign currency reserves by the government.

You will recall that a depreciation of the exchange rate causes import prices to increase and export prices to decrease, while an appreciation causes the opposite effects.

Fluctuation in the prices of commodities

Also in the short-run, there may be considerable fluctuation in the prices of commodities which will affect the terms of trade. This is particularly true for agricultural commodities, the supply of which is often affected by drought, floods, diseases, etc. Given that the demand for and supply of these commodities is highly inelastic, the change in supply will cause a proportionately greater change in price.

(b) Long-run

In the longer term, changes in the terms of trade are likely to be determined by those factors which exert a long term influence on the demand for, and supply of, a country's exports and imports.

For the developing countries, who export mainly primary goods and import manufactured goods, their export prices have tended to fall over time due to a combination of increased supply of and reduced demand for their exports.

Development of synthetic substitutes, e.g. plastics

This has lessened the demand for several raw materials from LDCs thus affecting their terms of trade.

Low income elasticity of demand for primary commodities

As real world incomes have grown, the demand for primary commodities has increased less than proportionately.

Agricultural protection

The developing countries, despite producing at lower cost, have found it difficult to break into the markets of the richer countries. As farmers they are often heavily subsidised and, in the case of the European Union, protected by a common external tariff.

Miniaturisation

Modern microchip technologies have enabled products to become smaller, e.g. the personal computer, and this has necessitated less use of raw materials and caused demand to fall.

Price inelastic demand for exports of primary commodities

Compounding the problem of falling export prices, demand for primary commodities tends to be price inelastic, such that decreases in prices bring about less than proportionate increases in the quantity demanded.

Change in factor endowments

Changes in factor endowments may increase exports or reduce them. With tastes remaining unchanged, they may lead to changes in terms of trade. Suppose there is an increase in Rwanda's supply of factors of production with constant change in tastes, its productive capacity would increase thus terms of trade would move towards Rwanda against Kenya.

Devaluation

Devaluation raises the domestic prices of imports and reduces foreign price of exports of a country devaluing its currency relative to the currency of another country.

Tariff

An import tariff improves the TOT of the imposing country, for example if a tariff is imposed on Rwanda's tea by Kenya, the changes in terms of trade are in favour of Kenya. Since the quantity of exports of Rwanda reduce as a result of tariff by Kenya is greater than the quantity of imports by Rwanda, the terms of trade definitely move in favour of Kenya.

Economic growth

The raising of a country's national product or income overtime (economic growth) affects the terms of trade of a country. Given the tastes and technology in a country, an increase in its productive capacity may affect favorably or adversely its terms of trade. As a result of economic growth, a country exports less that will bring much imports in the country.

Changes in tastes

Changes in tastes of people in a country also affect a country's TOT with another country. Suppose Kenya's tastes shift from Rwanda's tea to its own coffee, in this situation, Kenya would export less coffee to Rwanda and its demand for Rwanda tea would also fall. Thus Kenya's terms of trade would improve. On the contrary, a change in Kenya's taste for Rwanda's tea would increase its demand and hence terms of trade would deteriorate for Kenya.

Changes in technology

As technology changes, terms of trade of a country increase or decrease respectively, for example, if Rwanda uses poor technology compared to Kenya, the terms of trade would be in favour of Kenya against Rwanda. This is because Rwanda would export less and import more in return from Kenya. However, if Rwanda's technology advances, it will be better off as it exports more of its tea hence improving the terms of trade.

2.4.6 Consequences of changes in the terms of trade on balance of trade

Terms of trade refers to the purchasing power of the country's exports in terms of its imports.

Balance of trade refers to the difference in the value of visible exports and visible imports of a country in a particular period.

An improvement in the terms of trade means that export prices are increasing and import prices are reducing. Therefore, this leads unfavorable balance of trade because there will be a fall in exports and an increase in quantity of imports.

Deteriorating terms of trade means that export prices are reducing and import prices. This will consequently lead to favorable balance of trade because there will be an increase in the demand of exports because of its reducing prices, and reduction in the demand of imports because of increasing prices.

Deterioration in the balance of trade may also lead to deteriorating terms of trade. When there is deteriorating balance of trade this means a country is importing more and exporting less. Which also means that the country will spend more money on imports and getting less from exports? This means that the country's purchasing power of exports in terms of its import is low which means deteriorating terms of trade.

The Marshall Lerner condition also states that if demand for exports and imports is relatively elastic i.e. PED x + PED m >1, then an increase in terms of trade will worsen the balance of trade. In other words, if both exports and imports have elastic demand, it means that an increase in the price of exports will lead to reduction in the volume of exports, and reduction in the prices of imports leading to an increase in the volume of goods imported which worsens the balance of trade.

Sometimes elasticity of demand varies over time. In the short term demand is often inelastic; in the longer term demand becomes more elastic. Therefore, we can often see a "J Curve effect", where an improvement in terms of trade worsens current account in short term but improves in the long term.

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Unit assessment

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

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

Year	Export price index	Import price index	Terms of Trade
2012	100	100	100
2013	142	108	
2014	120	114	
2015	128	132	
2016	154	173	

   (i) Calculate the terms of trade for the years 2013 to 2016.

   (ii) Explain the nature of terms of trade in 2015 and 2016 respectively and support your answer.

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

   (b) Explain the effects of deteriorating terms trade in your country.

3. Does favourable terms of trade mean favourable balance of trade?

Glossary

- **Balance of trade**: The difference between the value of visible and invisible exports and imports.
- **Barter terms of trade**: The ratio of the quantity index of exports to the quantity index of imports.
- **Deteriorating terms of trade**: When a country experiences unfavourable terms of trade for continuous years.
- **Favourable terms of trade**: This refers to where a country's export prices are higher than her import prices.
- **Income terms of trade**: The ratio of income earned from exports to the price of imports.
- **Terms of trade**: The measure of import purchasing power of a country's export or the relationship between the price of a country's export and its expenditure on imports.
- **Unfavourable terms of trade**: This is when a country's import prices are higher than her export prices.
- **Visible balance**: Is difference in value of a country's physical imports and exports over a period of time.

Unit summary

- Terms of trade
  - Meaning
  - Forms of terms of trade
  - Nature of terms of trade in LDCs
  - Improving terms of trade
- Balance of trade
  - Meaning and calculations
  - Causes of changes in terms of trade
  - Consequences of changes in terms of trade on balance of trade

Topic Area 4: International Economics

Sub-Topic Area 4.1: International Trade

UNIT 3

Free Trade and Trade Protectionism

Key unit competence: Learners will be able to analyse the impact of free trade and trade protectionism in an economy.

My goals

By the end of this unit, I will be able to:

- Distinguish between free trade and trade protectionism.
- Discuss the impact of free trade and trade protectionism on an economy.
- Identify the objectives and tools of commercial policy in Rwanda.
- Evaluate the impact of free trade on Rwanda's economy.
- Analyse the need for trade protectionism in Rwanda and the likely dangers.
- Assess the tools of trade protectionism.
- Choose the appropriate trade system for economic development.

Activity 1

Analyze the extract below and answer the questions that follow.

In principle, free trade on the international level is no different from trade between neighbors, towns, or states. However, it allows businesses in each country to focus on producing and selling the goods that best use their resources while other businesses import goods that are scarce or unavailable domestically. That mix of local production and foreign trade allows economies to experience faster growth while better meeting the needs of its consumers. According to David Ricardo in his book, On the Principles of Political Economy and Taxation, free trade expands the diversity and lowers the prices of goods available in a nation while better exploiting its homegrown resources, knowledge, and specialized skills. https://www.investopedia.com/terms/f/free-trade.asp

Required:

(a) a) What according to you is meant by free trade?

(b) b) From the extract above, what are the benefits of free trade cited?

(c) c) How else do you think free trade is likely to affect the economies of the involved countries?

Suppose free trade turns out to be harmful to your country's economic development process, suggest the possible measures that can be used to protect her economy from the costs of such a trade policy.

Facts

3.1 Meaning of Free Trade

Free trade refers to the unrestricted purchase and sale of goods and services between or among countries without the imposition of constraints such as tariffs, duties, and quotas. It is a policy followed by some international markets in which countries' governments do not restrict imports from, or exports to other countries. In this case, government does not discriminate against imports or interfere with exports by applying some tariffs (to imports) or subsidies (to exports).

According to Adam Smith, the term "free trade" is used to denote "the system of commercial policy which draws no distinction between domestic and foreign commodities and, therefore, neither imposes additional burdens to the latter, nor grants any special favour to the former".

In other words, free trade implies complete freedom of international trade exchange. In this situation, there are no barriers to movement of commodities among countries and exchange can take its perfect natural course.

3.1.1 Advantages of free trade

Free trade is the term given to trade between nations that takes place without the imposition of barriers in the form of tariffs, quotas or other measures by governments or international organisations. Free trade is generally considered by economists to be beneficial to interntional trade by encouraging competition, innovation, efficient production and consumer choice etc. Its advantages include among others the following:

- Greater welfare: Free trade avails consumers in a particular country with a wider choice of goods, as they find imported as well as domestic goods on display in the shops. Thus Free trade permits large varieties of consumption goods and improves consumer's welfare.
- Domestic businesses may also have a chance to reduce costs by buying imported raw materials from abroad or importing new technology without restriction.
- Both individuals and businesses may have access to imported products that do not exist on the domestic market and would not be available without international trade.
- Comparative cost advantage: Free trade is the natural outcome of comparative advantage. It permits an allocation of resources, and manpower in accordance with the principle of comparative advantage which is just an extension of division of labour i.e. it boosts specialisation between or among countries involved where countries may boost their production by specialising in those industries for which their opportunity cost is lower than for their competitors.

- By engaging in free trade, countries may then export those goods or services that they are most efficient in producing and import the items which other countries may produce more efficiently.
- By concentrating on certain industries, it may be possible for countries and the firms operating in their territory to build up economies of scale that lower their costs and boost productivity.
- Generally, larger organisations may compete more efficiently on the international market by keeping control over their costs of production and managing their supply chain to reduce transport and inventory costs.
- Competition: Free trade increases competition as domestic industries must compete with foreign firms in the same industry as well as other firms in their own country. This compels domestic industries to look for ways to keep costs down by operating more efficiently and gives them an incentive to innovate and look for improved products, processes and marketing methods.
- Thus, this constant search for new ideas and technology induces domestic producers to become more alert and improve their efficiency which enables them to compete on the international market.
- More factor earnings: Under free trade, factors of production will also be able to earn more, as they will be employed for better use i.e. optimally utilised. Hence, wages, interest and rent will be higher under free trade than otherwise.
- Cheaper imports: Free trade procures imports at cheap rates thus favouring customers through reduced prices in the market.
- Enlarged market: Free trade widens the size of the market as a result of which greater specialisation and a more complex division of labour becomes possible. This brings about optimum production with costs reduced everywhere, benefiting the world as a whole.
- Restricted exploitation: Free trade prevents growth of domestic monopolies and consumer's exploitation from abroad.
- Free trade encourages the development of efficient entrepreneurs in given countries due to fear of competition, in order to maintain and improve their methods of production and this reduces their costs of production.

- It promotes international cooperation among countries and mutual understanding. This helps to improve on the atmosphere of peace and good will in the world hence increasing the volume of international trade.
- It widens tax base in the economy as a result of variety of goods and services produced and exchanged.
- It reduces administrative costs of protectionism such as enforcing quotas, foreign exchange control, subsidies etc.
- It eliminates possibilities of trade malpractices like smuggling with its negative effects e.g. reduction in government revenue through taxes.
- It increases employment opportunities since there is free movement of factors of production.

3.1.2 Disadvantages of free trade

- Free trade involves some risks for a country because the international market conditions are out of the control of any government and are often unpredictable and liable to fluctuation.
- As the terms of trade change, a particular industry in a country can fall into decline, resulting in factory closures and unemployment. The labour market is not fully flexible, and workers may have difficulty retraining for other industries or moving to other locations to find work. Structural unemployment may therefore cause problems for a country's economy.
- A country may become too dependent on the export of a particular commodity; this leaves the economy vulnerable to fluctuations in the price of that commodity. This is often the case with former colonies that were compelled to cultivate a limited number of crops such as cereals or mine for a particular metal.
- The price of agricultural products or minerals on the global market fluctuates greatly with changes in international supply and demand which are outside the control of the producer countries.

- The distribution of income between or among countries may be more uneven as a result of free international trade, because some countries will take advantage of natural resources, skilled workforce or economies of scale to sell their goods and services internationally on favourable terms.
- Within each particular country, free international trade may increase the gap between rich and poor because those who benefit most from international trade may be the rich elites who own the main assets of the country.
- For individual firms trading internationally, the business risks are increased. They are exposed to the risk of falls in demand as a result of changes in taste or fashion and problems resulting from the introduction of new technology or more efficient processes by their international competitors. Credit risks can be high and the cost of borrowing may increase unexpectedly, making such firms uncompetitive.
- Countries often need to become part of a larger trading bloc to obtain favourable terms of trade internationally, but such economic benefits may come at the cost of a loss of sovereignty, as important decisions affecting the national economy are made by the international trading bloc rather than by its individual members.
- The inflow of international goods into a country may cause other problems such as an erosion of the national culture.
- A country with unfavourable BOP finds it difficult to overcome this situation under free trade.
- Free trade may encourage interdependence and discourage self-reliance or sufficiency. But in the matter of defence each country should have self -reliance and self- sufficiency as far as possible.
- Competition induced under free trade is unfair and unhealthy. Backward countries cannot compete with advanced countries. i.e. Local infant industries are out-competed by cheap imported products from abroad since they cannot compete favourably with MDCs.
- It may lead to importation of undesirable commodities in the country which have adverse effects on consumers since there is no check on production and trade of various harmful goods. This undermines the health conditions of local people.

- It leads to dumping of out dated and poor quality commodities and reconditioned technology into the country.
- It may encourage brain drain and capital outflow/flight from LDCs to MDCs.

3.2 Trade Protectionism

Activity 2

1. Use the library or the internet or any other economics source and make more research on international trade, and using the acquired knowledge, analyse the following scenario;
   Rwanda exchanges different commodities between and among different countries all over the world.

   However, it is not all the time, that she exchanges with other countries at her wish. At times there are restrictions on her imports and exports e.g. through tariffs, quotas, standardisation measures, border checks, embargos/sanctions, total ban, import and export licenses, bureaucratic delays etc. This limits the number of commodities entering or leaving the country respectively. Basing on the above scenario, discussion the following:
   (a) What economic term is given to international trade with restrictions?
   (b) Why do you think countries need to restrict their trade with others?
   (c) Identify examples of trade barriers mentioned above that can be imposed on international trade.
   (d) What other policy measures can countries use to restrict trade with other countries in international trade?

Facts

3.2.1 Meaning of trade protectionism

Trade protectionism refers to the different forms of barriers imposed on international trade to influence the flow or volume of commodities exchanged. It is a commercial policy of safe guarding the national interests through restrictions on international trade. It is used to regulate the inflow and outflow of commodities between or among countries involved in international trade so as to allow fair competition between imports and goods and services produced domestically.

The doctrine of protectionism contrasts with the doctrine of free trade, where governments reduce as much as possible the barriers to trade.

3.2.2 Reasons for trade protectionism

- To protect infant industries against unfair competition from low cost products from abroad. Infant industries normally produce at high costs and their products are of poor quality and thus need to be protected from cheap and high quality import goods.
- To discourage dumping through tariffs on cheap and expired commodities into the country.
- To increase employment opportunities at home by reducing imports and stimulating domestic demand for local products which contains local industries in operation so that they can keep providing employment.
- To reduce external economic dependence and promote self-sufficiency e.g. through establishment of import substitution industries to produce formerly imported commodities to ensure self-reliance in the economy.
- To increase government revenue through import and export duties, of which revenue can be used to finance government programmes.
- To prevent importation of undesirable commodities and thus protect the health of citizens. e.g. ban of certain drugs, food staffs etc. on health grounds.
- To check imported inflation by increasing tariffs or prohibit importation of commodities facing hyper inflation.
- To encourage full utilisation of domestic resources especially for import substitution industrial strategy.

- To improve on the BOP position of a country i.e. restrictions may be imposed on imports in order to reduce them and improve BOP of a country because it would reduce foreign exchange expenditure abroad thus improving the BOP position of a country.
- For security purposes e.g. a country may impose restrictions like embargo or total ban on importation of strategic commodities like firearms, military hardware etc. to maintain security in the country.
- For retaliation purposes i.e. countries impose restrictions to retaliate against other countries restrictions on her exports.
- For political purposes e.g. discrimination in favour or against certain political groups.

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

Tools of protection are normally grouped into 2 namely;

(a) Tariff barriers and

(b) Non-tariff barriers

(a) Tariff barriers to trade

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

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

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

(b)Non- tariff barriers to trade

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

Forms of Non-tariff barriers to trade:

Foreign exchange control. Exchange control implies the government regulations relating to buying and selling of foreign exchange. The government then may allocate the foreign exchange among only the licensed importers so as to reduce the amount of foreign exchange given to importers in order to reduce on imports. In the same way the government may intervene in the foreign exchange market to lower the value of its currency by selling its currency in the foreign exchange market at higher price. Doing so will raise the cost of imports which discourage importation of goods.

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

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

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

Sanction: This is an official order, such as the stopping of trade that is taken against a country in order to make it obey international law. Trade sanctions target specific types of transactions, as in a prohibition to sell arms to a specific business, country, government or regime. The primary objectives of imposing sanctions are to maintain or restore international peace and security. Failure to comply with sanctions is a criminal offence. Governments impose sanctions with the express purpose of changing the behavior and policy of another government or state.

Embargo (a trading ban): Complete prohibition of commerce and trade with a particular country/state or a group of countries. Embargoes are considered strong diplomatic measures imposed in an effort, by the imposing country, to stimulate a given national-interest result from the country on which it is imposed.

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

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

Political campaigns advocating domestic consumption. This involves encouraging citizens to consume their home-made commodities e.g. the 'Made in Rwanda' campaign in Rwanda. This promotes the market for local products which has a number of benefits to citizens and in turn leads to reduction in the amount of goods imported.

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

Import licenses. This involves the giving of permission to a certain number of importers in order to regulate the inflow of imports. If the government of a country allows the import of foreign commodities to the licensed importers, the trade is very much brought under control because all unlicensed importers will be restricted from importing goods into the country which reduces on the physical amount of goods imported.

Export subsidies: These are put to allow exporters to supply the market with more product than the natural equilibrium would have allowed. Foreign consumers will enjoy increased economic welfare as the price of their purchases fall. Domestic employees might enjoy more wages and job security. But tax payers foot the bill for this. Domestic firms might divert trade into exports and ignore the home market. This could lead to increases in domestic prices.

Administrative obstacles - countries can set administrative hurdles. For example, they may require significant levels of paperwork and then deal with these processes slowly making it difficult for importers to compete on a level playing field with other firms.

Health and safety standards - countries may set burdensome/ high health and safety standards for goods that are imported, which discourages importation of certain commodities on health grounds making life difficult for importers to proceed.

Environmental standards - countries can set high environmental standards that they know only domestic firms are likely to be able to achieve, therefore regulating the level of importers in the country.

Voluntary export restraints (VERs): These are restrictions set by a government on the quantity of goods that can be exported out of a country during a specified period of time. Often the word voluntary is placed in quotes because these restraints are typically implemented upon the insistence of the importing nations. At times these quotas are voluntarily agreed between countries, often with a feeling that it would help avoid more punitive restrictions, or sometimes it may be in their interests..

3.2.4 Advantages/arguments for trade protectionism

Activity 3

Analyze the extract below and use it to carryout research on trade protectionism to answer the questions that follow.

Protectionist policies are typically focused around imports but may also involve other aspects of international trade such as product standards and government subsidies. The merits of protectionism are the subject of fierce debate. Critics argue that over the long term, protectionism often hurts the people and entities it is intended to protect by slowing economic growth and increasing price inflation, making free trade a better alternative. Proponents of protectionism argue that the policies can help to create domestic jobs, increase gross domestic product production, and make a domestic economy more competitive globally.

https://www.investopedia.com/terms/p/protectionism.asp

Required:

a) Based on the extract above, present arguments for and against trade protectionism therein.

b) Protectionism should be adopted if developing countries are to achieve high growth rates. Do you agree? Support your answer.

Facts

The main arguments which are advanced to support the policy of protectionism are as follows:

(i) Protectionism reduces unemployment: It has been claimed that the use of tariffs discourages imports and raises their prices to the domestic consumers. This leads to diversion of demand for goods produced at home. The home industry is encouraged and thus more employment is provided for the home population.

(ii) Preserves certain class of population or certain occupation: The government of a country on political or social grounds may favour protectionism for preserving certain classes of people or certain occupations, for instance, the agrarian population is generally more submissive and loyal to the government than the industrial population. If government wishes to preserve this class of people, then it will levy heavy import duties on foreign agricultural raw materials thus encouraging them to take more interest in farming.

(iii) Diversification of industries: Protection brings about a balanced economy in the country, if it is given to those industries which do not possess natural superiority. Under free trade, a country will specialise in the production of those commodities in which it has a relative price advantage over other countries. A country can specialise completely in one or few goods at the most. This means the country will put all 'her eggs in one basket', if war breaks out or the export prices of the goods go down, then it will face severe hardships.

(iv) It assists new industries: A newly established industry is just like a newly born baby. As the baby cannot grow up unless it is nursed and well protected, similarly, an infant industry cannot face the blast of foreign competition unless it is given full protection till it grows to its full structure. Thus protectionism protects infant industries against unfair competition from low cost imported products.

(v) Protectionism guards against dumping: Protectionism discourages dumping of cheap and at times substandard or expired goods in the country. If a foreign firm enjoying a monopolistic power or other advantages resorts to dumping with a view to capturing foreign markets, then the other countries must protect their industries by levying high protective duties on foreign goods. As selling of goods under cost (dumping) in other countries is temporary and spasmodic in nature, the anti-dumping duties should also be temporary. If dumping is permanent, then higher tariffs should be imposed permanently on foreign products.

(vi) Keeps money at home: Protectionism is also advocated on the grossly fallacious argument of "keeping money at home". When we buy manufactured goods abroad, we get the goods and the foreigners get the money. When we buy the manufactured goods at home, we get both the goods and the money.

(vii) Protectionism increases government revenue: Protectionism is also advocated on the ground that it raises revenue for the state through import and export duties. If prohibitive high tariffs are imposed on the import of foreign goods, then they may not be imported at all and the government would not be able to collect the revenue at all. On the other hand, if a moderate protection duty is levied, then it may serve both the purposes of collecting revenue and protecting industries.

(viii) Protection helps in checking imported inflation by putting sanctions or even total ban on commodities from countries affected by inflation.

(ix) Protectionism conserves national resources: Protection is essential for preserving the natural resources of a country. The unchecked trade often leads to exhaustion of mineral resources which are very vital for the development of the country.

(x) National defense: Protectionism has been advocated for on the ground that in times of war or any other emergency, an entire dependence on foreign goods which are very essential for defense or consumption purposes is very dangerous. It is stated, therefore, that a country must build up her own iron and steel Industry and develop farming industry even if these involve an economic loss to the country.

(xi) It reduces shortages in the home country by restricting exportation of certain commodities and favouring importation of such commodities which are scarce in the country.

(xii) It encourages full utilisation of domestic resources: If imports are discouraged and demand for domestic goods is encouraged, it encourages domestic producers to use the available idle resources in order to increase production to meet the domestic demand.

(xiii) It checks on the production and consumption of harmful products in the economy: High import duties on certain imported commodities or their total ban discourages inflow of such commodities on health and moral grounds which improve the standards of living of the citizens of the protecting countries.

3.2.5 Dangers of protectionism

- Market distortion and loss of allocative efficiency: Protectionism can be an ineffective and costly means of sustaining jobs.
- It may lead to trade diversion in case trade protectionism is in form of regional integration i.e. shifting from a cheap source to a high source of imports.
- It may lead to inflation due to high import tariff especially if imports have inelastic demand.
- Trade barriers between countries can spoil the relationship between them.
- It encourages smuggling which reduces government revenue and smuggled goods are always expensive.
- It promotes monopoly i.e. protected domestic industries will become monopolies and create the items of monopoly e.g. low output, inefficiency etc. due to lack of competition.
- Over protectionism leads to inefficiency whereby local producers will produce local quality goods and charge high prices thus cheating customers.
- Higher prices for consumers: Tariffs push up the prices for consumers and insulate inefficient sectors from genuine competition. They penalise foreign producers and encourage an inefficient allocation of resources both domestically and globally.

- Reduction in market access for producers: Export subsidies depress world prices and damage output, profits, investment and jobs in many lower-income developing countries that rely on exporting primary and manufactured goods for their growth.
- Loss of economic welfare: Tariffs create a deadweight loss of consumer and producer surplus. Welfare is reduced through higher prices and restricted consumer choice since imports are restricted and consumers may end up consuming low quality and expensive commodities. The welfare effects of a quota are similar to those of a tariff – prices rise because an artificial scarcity of a product is created.
- Extra costs for exporters: For goods that are produced globally, high tariffs and other barriers on imports act as a tax on exports, damaging economies, and jobs, rather than protecting them. It leads to high production costs thus high prices for domestic final goods due to the fact that LDCs normally import raw materials and spare parts.
- Regressive effect on the distribution of income: Higher prices from tariffs hit those on lower incomes hardest, because the tariffs (e.g. on foodstuffs, tobacco, and clothing) fall on products that lower income, families spend a higher share of their income.
- Production inefficiencies: Firms that are protected from competition have little incentive to reduce their production costs. This can lead to inefficiency and higher average costs.
- Trade wars: There is a danger that one country imposing import controls will lead to retaliatory action by another leading to a decrease in the volume of world trade. Retaliatory actions increase the costs of importing new technologies affecting long run average supply.
- Negative multiplier effects: If one country imposes trade restrictions on another, the resultant decrease in trade will have a negative multiplier effect affecting many more countries because exports are an injection of demand into the global circular flow of income.
- Second best approach: Protectionism is a second best approach to correcting a country's balance of payments problem or the fear of structural unemployment. Import controls go against the principles of free trade. In this sense, import controls can cause government failure.

- It may lead to scarcity inflation especially if there are high taxes on imports. This limits supply of goods and services in the country and it results into high prices for the few commodities available.
- It may lead to limited inflow of skilled labour into the country if they are highly taxed.

3.3 Commercial Policy

Activity 4

Base on the extract below to undertake research on commercial policy and answer the questions that follow;

The Republic of Rwanda is classified as a low-income country with an aim to transform the country into a lower middle-income economy by improving its business environment and competitiveness. The country was ranked 51st out of 132 countries in the World Economic Forum (WEF) Enabling Trade Index (2012) which measures institutions, policies and services to facilitate trade in countries. For its marked improvements in the business and regulatory environment for private business, Rwanda has been internationally commended as a lead reformer in East Africa. The country's improving business environment has contributed to its robust economic growth, by the government's continuous efforts to promote a private sector led free market economy. Rwanda is committed to improving trade with neighbouring countries and tackling the numerous non-tariff barriers that continue to hamper intra-regional trade. A National Cross-Border Strategy developed in August 2012, aims to foster stronger linkages between producers and manufacturers in Rwanda and in neighbouring countries. In spite of the government's efforts to diversify the economy, Rwanda is still heavily dependent on natural resources and commodities (WEF 2012; World Bank 2013; African Development Bank 2013).

Required.

(c) What do you understand by the term commercial policy?

(d) Why do you think Rwanda decided to undertake such a policy?

(e) What commercial policy tools have been undertaken by your country to improve her domestic commercial welfare?

(f) What benefits and costs has the Rwandan economy faced as a result of such a policy?

Facts

3.3.1 Meaning of commercial policy

A commercial policy or trade policy or international trade policy refers to all measures regulating the external economic relations of a country, that is, measures taken by a territorial government which has the power of assisting or hindering the exports or imports of goods and services". It is a set of rules and regulations that are intended to change international trade flows, particularly to restrict imports.

OR a set of measures adopted by the government of a country towards international trade aimed at improving domestic industrial and commercial welfare.

In modern times, the commercial policy of every country is generally based on the encouragement of exports and discouragement of imports. The exports are encouraged by giving preferential freight rates on exports; consular establishments subsidised merchant marines etc. The imports are hindered by erecting the tariff wails, exchange controls, quota system, buy at home campaign etc.

Every nation has some form of *trade policy* in place, with public officials formulating the policy which they think would be most appropriate for their country. Their aim is to boost the nation's international trade. The purpose of trade policy is to help a nation's international trade run more smoothly, by setting clear standards and goals which can be understood by potential trading partners. In many regions, groups of nations work together to create mutually beneficial trade policies.

Trade policy can involve various complex types of actions, such as the elimination of quantitative restrictions or the reduction of tariffs. According to a geographic dimension, there is unilateral, bilateral, regional, and multilateral liberalisation.

According to the depth of a bilateral or regional reform, there might be a free trade area (wherein partners eliminate trade barriers with respect to each other), a *customs union* (whereby partners eliminate reciprocal barriers and agree on a common level of barriers against non-partners) or a free economic area.

3.3.2 Objectives of commercial policy

The main objectives of commercial policy are:

- To increase the quantity of trade with foreign nations.
- To preserve, the essential raw materials for encouraging the development of domestic industries.
- To stimulate the export of particular products with a view to increasing their scale of production at home.
- To prevent the imports of particular goods for giving protection to infant industries or developing key industry or saving foreign exchange, etc.
- To restrict imports for securing diversification of industries.
- To encourage the imports of capital goods for speeding up the economic development of the country.
- To restrict the imports of goods with a view to correct the unfavorable balance of payments.
- To assist or prevent the export or import of goods and services for achieving the desired rate of exchange.
- To enter into trade agreements with foreign nations for stabilising the foreign trade.

3.3.3 Arguments for commercial policies

There are three proposed arguments offered as explanation for why nations adopt commercial policies:

1. The national defense theory

According to this argument, certain industries such as weapons, aircraft, and petroleum are vital to a nation's defense. Therefore, proponents of this theory argue that these domestic industries should be protected from foreign competitors so that there is a domestic supply on hand in case of an international conflict. No country would like to be dependent on another country when it comes to weapons.

2. The infant industry theory

Under this argument, it is believed that new domestic industries should be protected from foreign competition so that they will have a chance to develop. Ideally, as the new industry matures and becomes able to compete favourably with other producers on its own, the protections will be removed. It is intended to help a new domestic industry develop without being immediately crushed by already established foreign industries.

3. The anti-dumping theory

Dumping is simply the selling of a good in a foreign country at a lower price than it is sold for in the domestic market. It is an illegal practice and current laws provide relief in form of tariffs imposed against the violators. Proponents of this argument believe that if dumping is allowed, foreign producers will temporarily cut prices and drive domestic firms out of the market ans use their monopoly to exploit consumers. Anti-dumping legislation is implemented to prevent this.

3.3.4 Arguments against commercial policy

Increased cost to consumers

One of the most important disadvantages of trade restrictions is that they drive up the price of goods in a country where trade barriers artificially raise the prices of imported products. The apparent effect of trade barriers is to prevent jobs from being lost to foreign competition, which is an argument used by many special interest groups to justify various types of trade barriers. In the long run, however, trade barriers force consumers to pay higher prices, since products that could otherwise be made cheaply overseas take more resources to produce domestically.

Increased costs to domestic suppliers

Price hikes due to trade barriers don't just affect consumers. It also puts a strain on firms which supply raw goods and commodities to domestic industries. Without trade barriers in place, such firms can rely on the law of comparative advantage. This would cost them more to try to find a certain raw material in their own country than it would to buy from some country rich in a particular commodity. Trade barriers artificially raise prices on foreign commodities, making it less profitable to buy from other countries.

Less competition

Trade barriers lessen foreign competition, leading to fewer product choices for consumers. The fact that trade restrictions make it more costly to purchase goods from abroad, the domestic industry faces less competition from foreign markets. In the short term, this can save jobs in select domestic industries. However, in the long run, it leads to customers having fewer choices in the products they buy. It also gives producers less incentive to create high-quality products available to the public.

Escalations

Over time, one country's policy of trade restrictions may lead to similar measures taken by foreign governments, who may lose out in the international trade game because they can't export products for a profit. This cuts down on economic efficiency and competition on a global scale.

3.3.5 Instruments/tools of commercial policy

The main ***instruments or tools*** which are now days used for achieving the ***objectives of commercial policy*** are as follows:

(1) Tariffs or custom duties

Tariffs or custom duties may be defined as a schedule of duties/taxes authorised by territorial government to be imposed upon a list of commodities that are exchanged. Tariffs are generally classified into three classes. (a) Transit duties, (b) Import duties, (c) Export duties.

(a) ***Transit duties*** are those taxes which are levied upon merchandise passing through the country and consigned for another country. Transit duties are levied for raising money for the government.

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

(c) ***Export duties*** are those taxes which are imposed on the merchandise sent out of the country. Export duties, like import duties, are also imposed for raising revenue and to restrict the export of certain raw materials as a way of encouraging the development of domestic industries.

Custom duties may be discriminatory with respect to commodities of countries or it may be non-discriminatory. When a country is pursuing a discriminatory tariff policy, it may give:

(a) Preferential treatment by levying lesser custom duties upon the merchandise of some of the countries. (Or);

(b) Enter into an agreement with other countries for ensuring fair and equal treatment to the imports or exports of each member country. (Or);

(c) Join a common market where the merchandise of member countries are allowed free entry but the goods of other countries are subjected to tariffs.

(2) Bounties/subsidies on exports

In order to promote the export of a particular industry or the export of specified commodities, a government sometimes gives bounties on exports. The bounties or subsidies may be direct or indirect. When subsidy is paid in cash from the public treasury, the bounty is said to be direct and when low freight rates are charged on the goods to be exported or they are exempted from taxes, etc., the bounty or subsidy is said to be indirect.

(3) Direct restrictions on imports

The government may totally prohibit the importation of certain commodities into the country with the intent of increasing foreign exchange or for protection of domestic industries or for discouraging the use of particular commodities because they are injurious to health. The government may regulate the imports by means of quotas. Under quota system, the maximum amount of a commodity which can be imported during a particular period is fixed by the government. In recent years, governments of most countries are employing the import quota system because:

(i) It is very flexible and can be adjusted by the administrative authorities without resorting to legal action.

(ii) The home producers know in advance the total quantity of goods to be imported during a particular period, so they can regulate their output accordingly.

It arouses less resentment than the custom duties from the consumers.

(4) Trade agreements

The government of a country may enter into trade agreements with other countries for the exchange of goods. The trade agreements may be bilateral or multilateral. When two countries make a trade agreement for the exchange of goods, the agreement is said to be bilateral. When more than two countries enter into, trade agreement for ensuring fair and equal treatment to the imports and exports of the member countries, the agreement is called multilateral.

(5) Beggar-my-neighbour policy

This is an economic policy through which one country attempts to remedy its economic problems by means that tend to worsen the economic problems of other countries.

(6) Economic integration

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

(7) Devaluation

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

(8) Import substitution strategy

This is where a country establishes domestic enterprises to produce most of her requirements at home and participate less in international trade. This is done with the intent of reducing import expenditure.

(9) Foreign exchange control

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

(10) Basic infrastructure policy

This involves expansion and improvement of domestic infrastructure to promote domestic production.

Unit assessment

1. (a) Distinguish between barriers and non-tariff barriers to trade.
   (b) Explain the various tools used to restrict international trade in your country.
2. (a) Why do some countries adopt protectionism as an international trade policy?
   (b) Examine the problems that may arise from protectionist policies.
3. (a) What is trade liberalisation?
   (b) Would you advocate for trade liberalisation, why?

Glossary

- **Anti-dumping duty**: A tariff imposed to restrict the importation of goods that are below standard. (dumping)
- **Beggar-my-neighbour policy**: This a policy adopted by a country to benefit its own economy but harmful to other economies e.g. import restriction, devaluation etc.
- **Drawback**: This occurs when a duty imposed on certain imports not destined for domestic consumption and subsequently exported, is refunded. This repayment of duty is what is called drawback.
- **Effective tariff rate**: A tax charged on any imported commodity expressed as a percentage of the value added by the exporting country.
- **Export quota**: The maximum amount of the product that may be exported in a given period of time.
- **Free Trade**: Trade in which goods can be exported or imported without any form of restrictions by the state.
- **Import quota**: This refers to the maximum amount of the product that may be imported in a given period of time.
- **Nominal rate of tariff**: A tax charged on any commodity expressed as a percentage of the price of the commodity.
- **Non-tariff barriers**: Devices other than tariffs that are devised to reduce the flow of imports e.g. quotas, total ban, sanctions etc.
- **Tariff war**: This refers to the competitive use of tariff by countries to change the pattern of international trade in an endeavor to gain individual advantage.
- **Tariffs**: These are taxes or duties imposed on goods imported or exported either for revenue purposes or for protection or both.

- **Trade barriers**: Any number of protectionist devices by which governments discourage imports. Tariffs and quotas are the most visible barriers, but in recent years, non-tariff barriers such as burdensome regulatory proceedings, have replaced more traditional measures.
- **Protectionism**: Advocacy of policies designed to protect domestic industries from foreign competition, usually in the form of tariffs, import quotas, or export subsidies.
- **Quota**: A quota is a legal restriction on the quantity of a good that may be imported or exported.

Unit summary

- Free trade
  - Meaning
  - Advantages and disadvantages
- Trade protectionism
  - Meaning
  - Reasons for trade protectionism
  - Tools of trade protectionism
  - Dangers of trade protectionism
- Commercial policy
  - Meaning
  - Objectives
  - Tools of commercial policy

Topic Area 4: International Economics

Sub-Topic Area 4.1: International Trade

UNIT 4

Balance of Payment (BOP)

Key unit competence: Learners will be able to analyse the balance of payment position of LDCs.

My goals

By the end of this unit, I will be able to:

- Explain the terminologies used in BOP.
- Distinguish between BOP equilibrium and disequilibrium.
- Describe the structure of BOP accounts.
- Analyse the causes of BOP deficit in LDCs.
- Account for the causes of BOP problems in Rwanda.
- Design BOP accounts.
- Design measures to offset BOP deficit/surplus on the BOP accounts.
- Suggest possible solutions to BOP problems in Rwanda.

Activity 1

Country 'B' revealed its capacity to save to pay for its imports in 2019. It also showed how much economic output it produced to pay for her growth for that particular year. In 2018, it had shown that it had experienced her imports of goods, services and capital being greater than its exports while in 2019, it showed that her exports of goods, services and capital were more than its imports. For all the positions of country 'B' in the years mentioned, however, she would endeavor to bring back her economy to equilibrium.

Required:

Analyze the case study above and use it to carry out research from any economics related resource to;

i) Explain the economic term that is given to the document that Country 'B' used to present her capacity to save for the payment of its imports and her output produced to pay for her growth.

ii) Describe economic situation in 2018 and 2019 respectively as stated in the case study.

iii) Explain the resultant outcome for each position mentioned in ii) above.

iv) Explain what, according to the case study, is described as 'equilibrium'.

iv) Identify the likely measures country 'B' would put to bring her economy back to equilibrium.

v) Based on the knowledge gained from unit 2, distinguish balance of trade from balance of payment.

Facts

4.1 Meaning of Balance of Payment (BOP)

Balance of Payment (BOP) is a statement that summarises an economy's transactions with the rest of the world for a specified period of time. It is a summary statement of a nation's financial transactions with the outside world. It shows the relationships between a country's total expenditure abroad with its total income from abroad.

The balance of payments, also known as balance of international payments, encompasses all transactions between a country's residents and its non-residents involving goods, services and income; financial claims on and liabilities to the rest of the world; and transfers such as gifts.

These transactions are made by individuals, firms and government bodies. Thus the balance of payments includes all external visible and non-visible transactions of a country. It represents a summation of a country's current demand and supply of the claims on foreign currencies and of foreign claims on its currency.

These transactions include payments for the country's exports and imports of goods, services, financial capital, and financial transfers. It is prepared in a single currency, typically the domestic currency for the country concerned. Sources of funds for a nation, such as exports or the receipts of loans and investments, are recorded as positive or surplus items. Uses of funds, such as for imports or to invest in foreign countries, are recorded as negative or deficit items.

Thus earnings from both visible and invisible exports and expenditures on both visible and invisible imports are recorded. The difference between visible exports and imports is known as balance of trade while the difference between invisible exports and imports is known as balance of invisible trade. Therefore, that is why BOP earnings from both visible and invisible exports and expenditure on both visible and invisible imports are recorded.

If total expenditure abroad is greater than total receipts from abroad, there is a BOP deficit or unfavourable BOP. If total receipts from abroad are greater than total expenditure abroad, there is BOP surplus or favourable BOP. Therefore, a BOP deficit and BOP surplus represent BOP disequilibrium.

4.1.1 Difference between balance of trade and balance of payment

Table 1: Difference between Balance of Trade and Balance of Payment

1- Definition

Balance of Trade (BOT)	Balance of Payment (BOP)
BOT is the difference between the values of exports and imports of only physical items (goods) of a country during a given period of time (usually one year).	BOP is the difference between the values of exports and imports of both visible and invisible items (goods and services) of a country during a given period of time (usually one year).

2- Surplus or Deficit

Balance of Trade	Balance of Payment
If the value of visible exports is greater than value of visible imports, the balance of trade is said to be favourable and vice versa.	If the value of the total receipts is greater than the total payments, the BOP is termed as favourable and vice versa.

3- Goods and Services

Balance of Trade	Balance of Payment
It includes only (visible) goods.	It includes both (visible and invisible) goods and services.

4- Revenue and Capital

Balance of Trade	Balance of Payment
It includes all revenue receipts and payments on account of imports and exports.	The BOP includes all revenue and capital items.

5- Relationship

Balance of Trade	Balance of Payment
The BOT does not include the BOP. It is the part of BOP.	The BOP includes BOT also. Accordingly, it is equal to the BOT plus import & export of services.

6- Economic Position

Balance of Trade	Balance of Payment
It does not show the actual economic position of a country.	Balance of payment shows the real economic position of a country.

4.2 Terminologies used in BOP

BOP deficit or unfavourable BOP: This is where total expenditure abroad is greater than total receipts from abroad.

BOP surplus or favourable BOP: This is where total receipts from abroad are greater than total expenditure abroad.

BOP disequilibrium: This is where receipts from abroad are not equal to expenditures abroad i.e. there is a BOP deficit or a BOP surplus.

BOP equilibrium: This is a situation where revenues from abroad are equal to expenditures abroad.

BOP accounts: It is a statistical record of the character and dimensions of the country's economic relationships with the rest of the world.

4.3 Structure of BOP Accounts

Activity 2

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

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

(a) What does the table portray?

(b) Why are some items recorded as credit items while others as debits?

(c) What examples can you give on transfers on either side?

(d) What does direct investment by foreign countries and direct investment in foreign countries mean?

(e) Describe how each account works..

Facts

Figure 1: Structure of BOP

Credits	Debits
Items of current account	
Exports of goods	Imports of goods
Exports of services	Imports of services
Unilateral transfer receipts (gifts, indemnities from foreigners)	Unilateral transfer payments (gifts, indemnities to foreigners)
Income receipts	Income payments
Items of capital account	
Capital receipts (borrowings from capital repayments by sale of assets to foreigners)	Capital payments (lending to, capital repayments to or purchase of assets from foreigners)

The balance of payments account of a country is a systematic record of all its economic transactions with the outside world in a given year. It is a statistical record of the character and dimensions of the country's economic relationships with the rest of the world.

The balance of payments account of a country is constructed on the principle of *double-entry book-keeping*. Each transaction is entered on *the credit and debit side of the balance sheet*. In balance of payments accounting, the practice is to show credits on the left side and debits on the right side of the balance sheet.

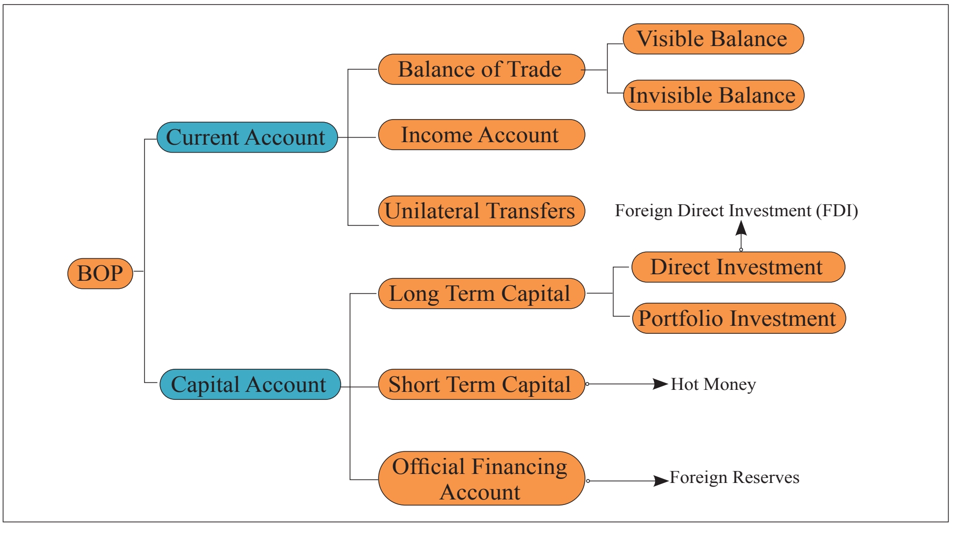
When a payment is received from a foreign country, it is a credit transaction while payment to a foreign country is a debit transaction. The principal items shown on the credit side (+) are exports of goods and services, unrequited (or transfer) receipts in the form of gifts, grants etc. from foreigners,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

The principal items on the debit side (-) include imports of goods and services, transfer (or unrequited) payments to foreigners as gifts, grants, etc., lending to foreign countries, investments by residents to foreign countries and official purchase of reserve assets or gold from foreign countries and international agencies.

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

4.3.1 Balance of payments account

Figure 2: Nature of BOP accounts



A balance of payments account is broken down into the current account, the capital account and the official settlements balance.

1. Current account

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

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

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

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

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

In the current account, the exports of goods and services and the receipts of transfer payments (unrequited receipts) are entered as credits (+) because they represent receipts from foreigners. On the other hand, the imports of goods and services and grant of transfer payments to foreigners are entered as debits (-) because they represent payments to foreigners. The net value of these visible and invisible trade balances is the balance on current account.

2. Capital account

The capital account of a country consists of its transactions in financial assets in the form of short-term and long-term lendings and borrowings and private and official investments. In other words, the capital account shows international flows of loans and investments, and represents a change in the country’s foreign assets and liabilities.

Long-term capital transactions relate to international capital movements with maturity of one year or more and include direct investments like building of a foreign plant, portfolio investment like the purchase of foreign bonds and stocks and international loans. On the other hand, short- term international capital transactions are for a period ranging between three months and less than one year.

There are two types of transactions in the capital account—private and government. Private transactions include all types of investment: direct, portfolio and short-term. Government transactions consist of loans to and from foreign official agencies.

In the capital account, borrowing from foreign countries and direct investment by foreign countries represent capital inflows. They are positive items or credits because these are receipts from foreigners. On the other hand, lending to foreign countries and direct investments in foreign countries represent capital outflows. They are negative items or debits because they are payments to foreigners. The net value of the balances of short-term and long-term direct and portfolio investments is the balance on capital account. The sum of current account and capital account is known as the basic balance.

3. The official settlements account or official financing account (cash or monetary account)

The official settlements account or official reserve assets account is, in fact, a part of the capital account. "The official settlements account measures the change in nations' liquidity and non-liquid liabilities to foreign official holders and the change in a nation's official reserve assets during the year.

The official reserve assets of a country include its gold stock, holdings of its convertible foreign currencies and SDRs, and its net position in the IMF". It shows transactions in a country's net official reserve assets.

This account records all the transactions related to the change in the country's foreign exchange reserves. It shows the official foreign reserves in response to current and capital accounts. If there is a surplus on the combined current and capital accounts, this means that the foreign exchange reserves of a country have increased. If there is a deficit on the combined current and capital accounts, this means that the foreign exchange reserves of a country have decreased.

4. Errors and omissions

Errors and omissions is a balancing item so that total credits and debits of the three accounts must equal in accordance with the principles of double entry book-keeping so that the balance of payments of a country always balances in the accounting sense.

In theory, the Capital and Financial Account balance should be equal and 'opposite' to the Current Account balance so that the overall Account balances, but in practice this is only achieved by the use of a balancing item called net errors and omissions. This device compensates for various errors and omissions in the balance of payments data, and which brings the final balance of payments account to zero.

The errors may be due to statistical discrepancies & omission may be due to certain transactions not recorded. For example, a remittance by a Rwandan working abroad to Rwanda may not get recorded, or a payment of dividend abroad by an MNC operating in Rwanda may not get recorded and so on. The errors and omissions amount equals to the amount necessary to balance both the sides.

Table 2: Example of autonomous and accomodating transactions

CREDITS			DEBITS		
Current account			**Current account**		
Autonomous transactions			***Autonomous transactions***		
1.	Exports of goods	550	1.	Imports of goods	800
2.	Exports of services	150	2.	Imports of services	50
3.	Unrequited receipts		3.	Unrequited payments	
4.	Gifts	75	4.	Gifts	20
5.	Indemnity	25	5.	Remittances	60
Capital account			**Capital account**		
Accommodating transactions			***Accommodating transactions***		
6.	Borrowings	200	6.	Lending	70
7.	Receipts	1000	7.	Payments	1000

4.3.2 Financing deficits/how to correct a BOP deficit

Activity 3

Fill in the following gaps

1. a) If excess demand for foreign currency in some periods is balanced with excess supply in other periods, then falling reserves in some periods will be offset with rising reserves in other periods leading to ………………………………………………………………… …………………………………………………………

   b) When the central bank buys domestic currency and sells the foreign reserve currency in the private Forex, the transaction indicates a ………………………………………………………………… …………………………………………………………

   c) When the central bank sells domestic currency and buys foreign currency in the Forex, the transaction indicates a ………………… ………………………………………………………………… …………………………………………………………

2. What should be done to rectify the two situations mentioned in b and c above?

Facts

A BOP deficit is a situation where aggregate demand for foreign exchange exceeds aggregate supply for foreign exchange. Methods to offset a BOP deficit should aim at reducing foreign exchange expenditure, increasing foreign exchange earnings and simultaneous reducing foreign exchange expenditure and increasing foreign exchange earnings. The financing of a deficit is achieved by:

1. Selling gold or holdings of foreign exchange, such as US dollars, yen or euros, etc.
2. Borrowing from other Central Banks or the International Monetary Fund (IMF).
3. Using the foreign exchange reserves available.
4. Sale of public assets abroad .
5. Seeking aid and grants from other countries.
6. Attracting foreign investments into the country.

7. Import substitution strategy.
8. Restrictive monetary policy i.e. reduces the amount of money in circulation.
9. Improving the service industry e.g. tourism.
10. Devaluation.
11. Export promotion strategy — increasing the volume of exports and improving the quality of exports.
12. Increasing taxes and reducing government expenditure i.e. fiscal policy.
13. Direct control — tariffs; quotas; exchange controls; complete ban, i.e. import restrictions.

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

4.3.3 Financing surplus/ how to offset a BOP surplus

A BOP surplus is a situation where aggregate supply of foreign exchange exceeds aggregate demand for it. A surplus will be disposed off by:

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

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

4.3.4 Why does the balance of payments always balance?

When all components of the BOP accounts are included, they must sum to zero with no overall surplus or deficit. For example, if a country is importing more than it exports, its trade balance will be in deficit, but the shortfall will have to be counterbalanced in other ways – such as by funds earned from its foreign investments, by running down Central bank reserves or by receiving loans from other countries.

Current account balance + Capital account balance + net errors and omissions = 0

Net errors and omissions simply reflect mistakes. Assuming no mistakes are made, then the formula will look like this.

Current account + Capital account = 0, hence Current account = Capital account.

In other words, if a country has a deficit on the current account (more imports than exports) then it must have an equal and opposite surplus on the capital account (and vice versa).

While the overall BOP accounts will always balance when all types of payments are included, imbalances are possible on individual elements of the BOP, such as the ***current account***, the ***capital account*** excluding the Central bank's reserve account, or the sum of the two. Imbalances in the latter sum can result in surplus countries accumulating wealth, while deficit nations become increasingly indebted.

The term ***balance of payments*** often refers to this sum: a country's balance of payments is said to be in surplus (equivalently, the balance of payments is positive) by a specific amount if sources of funds (such as export goods and bonds sold) exceed uses of funds (such as paying for imported goods and paying for foreign bonds purchased) by that amount. There is said to be a balance of payments deficit (the balance of payments is said to be negative) if the former are less than the latter. A BOP surplus (or deficit) is accompanied by an accumulation (or decumulation) of *foreign exchange reserves* by the *Central bank*.

Under a *fixed exchange rate* system, the Central bank accommodates those flows by buying up any net inflow of funds into the country or by providing foreign currency funds to the *foreign exchange market* to match any international outflow of funds, thus preventing the funds flows from affecting the *exchange rate* between the country's currency and other currencies. Then the net change per year in the Central bank's foreign exchange reserves is sometimes called the balance of payments surplus or deficit. Alternatives to a fixed exchange rate system include a *managed float* where some changes of exchange rates are allowed, or at the other extreme a purely ***floating exchange rate*** (also known as a purely ***flexible*** exchange rate). With a pure float, the Central bank does not intervene at all to protect or devalue its ***currency***, allowing the rate to be set by the ***market***, and the ***Central bank's foreign exchange reserves*** do not change, and the balance of payments is always zero.

However, during transactions, a country may register a deficit or surplus. If a country runs a deficit for a long time and for successive years, such a country is said to face BOP problems and this is common in LDCs.

4.3.5 Causes of BOP deficits in LDCs

Activity 4

At the beginning of this unit, we saw that at a certain point in time, a country can experience either of the two situations; i.e. where aggregate demand for foreign exchange exceeds aggregate supply of it or, where aggregate supply of foreign exchange exceeds aggregate demand for it. Undertake research on BOP position of developing countries to;

i) Describe what BOP position you think is commonly experienced in developing countries with a clear justification.

ii) Analyse the causes of such a situation in most developing countries?

iii) How do you think such a trade position impacts developing countries' economies?

What practical measures should be taken by developing countries to rectify such a position in international market?

Facts

BOP deficits in LDCs are caused by both socio-economic and political factors as below:

1. Narrow export base

Most LDCs, Rwanda inclusive, are basically agricultural countries. Their export base is narrow. Major exports are coffee, rice, cotton, raw wool, leather, fish etc. They concentrate in relatively low value added products which fetch low prices hence less earnings in return.

2. Consumption oriented society

Most people in LDCs are consumption oriented. Due to rapid rise in population and increased consumption habits, the domestic manufactured goods are mostly consumed in the country. The exportable surplus is declining. Governments have to import more in order to support the alarming population thus causing much expenditure abroad leading to BOP deficits.

3. Poor technology in less developed countries

There is less modernisation, balancing and replacement of machinery in the industrial sector in most LDCs' economies. This has led to a fall in production and decline in the quality of products that has adversely affected exports.

4. Production of primary products

Most LDCs produce and export primary products which are both price and income inelastic thus earning less from international trade. The share of value added goods must increase to earn foreign exchange and turn the trend of adverse balance of payment. The production of value added goods is at basic stage in developing countries that leads to adverse BOP.

5. Devaluation

The repeated devaluation of developing countries' currencies has not helped in the increase of exports. It has made the imported inputs more costly. The demand for their goods in the international market is inelastic. As such, devaluation as a tool for boosting exports is not effective.

6. Tough competition

Stiff competition from the foreign value added goods has reduced the volume of foreign trade in developing countries. There is availability of higher standard goods at lower prices in international market. It causes reduction in LDCs' exports, which result in deficit in BOP.

7. Increase in prices of inputs

The increase in the prices of fuel, electricity, high capital costs of imported machinery, exchange rates etc, have inflated LDCs' product prices. The high costs of both imported capital goods and industrial raw materials, on which domestic industries are heavily dependent, and the inflationary impact of the rise in the prices of inputs are not helping in achieving the export targets set in each financial year and this results into deficit in BOP.

8. Heavy protectionist policies by MDCs

Protectionist policies by developed countries on LDCs like imposition of tariff and non-tariff barriers have adversely affected LDCs' exports. The advanced countries of the world have imposed technical barriers such as patents, copyrights, trade-marks and designs etc. on their imports. LDCs have to upgrade the standard of purity and quality to compete for their products in the international market thereby leading to less foreign exchange earnings by LDCs and consequently BOP deficits.

9. Fall in terms of trade

The import unit values are higher than the export unit values for most LDCs. A decline in terms of trade causes imbalance in the balance of payment.

10. Foreign debts servicing

High expenditure on debt servicing since most countries in LDCs are poor and mostly rely on foreign resources especially through borrowing.

11. Importation of capital goods

Most LDCs import expensive capital goods for rapid industrialisation of their countries in order to build up the economy. The heavy import of machinery has considerably increased the import bill and has adversely affected balance of payment.

12. High demonstration effect

Most LDCs have import oriented economies through demonstration effect leading to high demand for capital and luxurious goods thus leading to high foreign exchange expenditure which adversely affect BOP position.

13. Rise in oil prices

The sharp rise in the prices of oil in the recent past is taking a big amount of the foreign exchange earnings. LDCs import bill of petroleum group increases year after year leading to BOP problems in LDCs.

14. Political instabilities and insecurity

Experience shows that political instability and disturbances in LDCS cause large capital outflows and hinder inflows of foreign capital. For example, the wide spread political instabilities and insecurity in most LDCs discourage production which reduces on the volume of exports. On the other hand, LDCs have to purchase modern weapons for their defense at a very high cost from different countries, this increases burden on their BOP and it becomes adverse.

15. Fluctuations in the prices of exports of LDCs

Since LDCs normally export primary products, their prices keep on fluctuating in the international market. This causes BOP deficit when export prices fall.

16. Imported inflation

Since most LDCs import expensive capital goods, it makes production expensive, leading to expensive exports which reduces their demand in the external markets. Thus, less foreign exchange is earned from them.

17. High population growth in LDCs

High population growth in poor countries adversely affects their BOP because it increases the needs of the countries for imports and decreases their capacity to export.

18. Natural calamities in LDCs

Natural calamities like bad weather reduce the yields from the agricultural sector as their dominant export sector thus leading to adverse BOP.

19. Poor infrastructure in most LDCs

Most LDCs have poorly developed and insufficient socio-economic infrastructure which causes supply rigidities (difficulties). This lessens export volume and consequently less earnings from them.

20. Changes in fashions, tastes and preferences in the world market.

This has reduced on the demand for LDCs exports thus adversely affecting their BOP position.

21. Unfair International Commodity Agreement (ICA)

Weak ICA has less bargaining powers in the international markets leading to low export prices and low earnings from exports hence BOP deficits.

22. Insufficient export promotion institutions

Institutions to promote export sector through encouraging vent for surplus in most LDCs are so insufficient.

23. Inflation in most LDCs' economies

Most LDCs' economies are hit by inflation which makes their exports expensive leading to low demand for them in the international markets thus earning less from them.

24. Depreciation of LDCs currencies

Persistent depreciation of LDC's currencies has made their products (exports) cheap and made imports expensive thus high foreign exchange expenditure.

4.3.6 Effects of BOP deficits

1. If a BOP deficit is financed through borrowing, it is said to be more unsustainable. This is because borrowing is unsustainable in the long term and countries will be burdened with high interest payments. Countries with large interest payments have little left over to spend on investment.
2. If a country runs a BOP deficit on the current account, it has to run a surplus on the financial / capital account. This means foreigners have an increasing claim on your assets, which they could desire to be returned at any time. For example, if you run a current account

deficit, it could be financed by foreign multinationals investing in your country or the purchase of assets. There is a risk that your best assets could be bought by foreigners, reducing long term income.

3. A current account deficit may imply that you are relying on consumer spending, and are becoming uncompetitive. This leads to lower growth of the export sector.
4. A Balance of payments deficit may cause a loss of confidence by foreign investors. Therefore, there is always a risk, that investors will remove their investments causing a big fall in the value of your currency (devaluation). This can lead to decline in living standards and lower confidence for investment.
5. A trade deficit can lead to currency weakness and higher imported inflation which worsens the BOP position further.
6. Deficit countries need to import financial capital to achieve balance. This in the long run leads to capital flight in form of profit repatriation.
7. Trade deficit can lead to loss of jobs in home-based industries as investors are discouraged from investing in the country.
8. Countries may run short of vital foreign currency reserves. This worsens the value of the local currency and people would lack confidence in it and resort to investing in foreign countries. As a result, economic development is retarded.
9. Currency weakness can lead to capital flight / loss of investor confidence. This creates savings-investment gap which calls for seeking aid and grants, and its negative consequences, that hinders further long term investments in the country thus underdevelopment.
10. A deficit leads to lower aggregate demand and therefore slower growth in development. This is due to the fact that people are earning less from their exports which reduces their purchasing power.
11. In the long run, persistent trade deficits undermine the standard of living. As it becomes less profitable to export, importing would also be problematic due to less earnings from trade thus worsening the standard of living of people.
12. A trade deficit is a reflection of lack of price / non-price competitiveness.

4.3.7 Measures to correct disequilibrium in BOP in LDCS

Sustained or prolonged deficit has to be settled by short term loans or depletion of capital reserve of foreign exchange and gold. The following remedial measures are recommended:

1. Export promotion: Exports should be encouraged by granting various bounties/ incentives to manufacturers and exporters. At the same time, imports should be discouraged by undertaking import substitution and imposing reasonable tariffs.
2. Import restrictions and Import substitution i.e. by increasing import duties on commodities similar to those produced at home, encouraging domestic industries to use local raw materials.
3. Controlling inflation through restrictive monetary policy: Inflation (continuous rise in general price levels) discourages exports and encourages imports. Therefore, government should check inflation and lower the prices in the country.
4. Exchange control: Government should control foreign exchange by ordering all exporters to surrender their foreign exchange to the Central bank and then ration out foreign exchange among licensed importers.
5. Devaluation of domestic currency: It means legal reduction in the external (exchange) value of domestic currency in terms of a unit of foreign exchange. This makes domestic goods cheaper for the foreigners. Devaluation is done by a government order when a country has adopted a fixed exchange rate system. Care should be taken that devaluation should not cause rise in internal price level.
6. Depreciation: Like devaluation, depreciation leads to a fall in external purchasing power of home currency. Depreciation occurs in a free market system where demand for foreign exchange far exceeds the supply of foreign exchange in foreign exchange market of a country (Mind, devaluation is done in fixed exchange rate system.)
7. Encouraging investors through establishing institutions that help and advise them on investment prospects in the country.
8. Opening new markets and making regional groupings to widen markets for their exports.
9. Ensuring political stability and security so as to ensure a conducive investment climate and a reduction on military expenditure.

10. Training local manpower e.g. through universal primary and secondary education and setting up different training institutions so as to increase skills of indigenous manpower and to reduce foreign expatriates.
11. Rehabilitation and construction of socio-economic infrastructure to increase supply of exports.
12. Seeking and being granted a debt relief so as to reduce expenditure on debt servicing.
13. Population control programmes should be enforced so as to reduce on dependence burden and import expenditure.
14. Innovations and inventions to improve on technology so as to improve on productivity increase the volume of exports and foreign exchange earnings as well.
15. The tourism industry should be strengthened as an export diversifier.
16. Strengthening the ICA so as to increase the export volume and bargaining power as well.
17. Economic legalisation so as to increase domestic productivity and export volume.

4.4 BOP Position in Rwanda

The current account balance in relation to GDP was consistently negative throughout the 1990s, not only because of the 1994 genocide. Although the economy improved dramatically post-1994, export earnings in the early 2000s were hindered by low international coffee prices, depriving the country of hard currency. Rwanda's external debt stood at 1.3 billion dollar in 2000. In the same year, Rwanda became eligible for 810 million dollars in debt service relief from the ***IMF/World Bank*** Heavily Indebted Poor Countries (HIPC) initiative. In 2002, the IMF approved a three-year 5 million dollar loan to Rwanda.

The US Central Intelligence Agency (***CIA***) reports that in 2001, the purchasing power of Rwanda's exports was 61 million USD while imports totaled 248 million USD resulting in a trade deficit of 187 million USD.

The International Monetary Fund (IMF) reports that in 2001 Rwanda had exports of goods totaling 93 million USD and imports totaling 245 million USD. The services credit totaled 50 million USD and debit 189 million

USD. The following table summarises Rwanda's balance of payments as reported by the IMF for 2001 in millions of US dollars.

In 2014, Rwanda's overall balance of payments recorded a deficit of 185.7 million USD as a result of a 15.3 percent increase in imports of goods which more than offset an increase of 6.8 percent in exports. Capital grants increased from 234.5 million USD in 2013 to 306.9 million USD in 2014.

Current account balance (% of GDP) in Rwanda

Current account balance (% of GDP) in Rwanda was last measured at -7.47 in 2013, according to the World Bank. Current account balance is the sum of net exports of goods, services, net income, and net current transfers.

4.4.1 Causes of BOP deficits in Rwanda

Activity 5

Basing on the knowledge gained from your previous research on international trade and BOP in LDCs generally, from your own analysis;

i) What BOP position is recently faced by your country? support your answer.

ii) Examine the causes of such a BOP position stated above.

iii) How has such a position affected the development process of your country?

iv) What policy measures have been put in place to rectify such problems?

Facts

BOP deficits in Rwanda are caused by both socio-economic and political factors as below;

1. ***Narrow export base***: Rwanda, like any other LDC, is basically an agricultural country. Thus her export base is narrow. Major exports are coffee, rice, cotton, raw wool, leather, fish etc. she concentrates in relatively low value added products which fetch low prices hence less earnings in return.

2. ***Consumption oriented society***: Most people in Rwanda are mostly consumption oriented. Due to rapid rise in population and increased consumption habits, the domestic manufactured goods are mostly consumed in the country. The exportable surplus is going on declining. The government has to import more in order to support the alarming population thus causing much expenditure abroad leading to BOP deficits.
3. ***Poor technology in less developed countries***: There is less modernisation, balancing and replacement of machinery in the industrial sector in Rwanda. This has led to a fall in production and decline in the quality of products and this has adversely affected exports.
4. ***Less income from international trade:*** Rwanda produces and exports primary products which are both price and income inelastic thus earning less from international trade. The share of value added goods must increase to earn foreign exchange and turn the trend of adverse balance of payment. The production of value added goods is at basic stage in Rwanda that leads to adverse BOP.
5. ***Rwanda faces stiff competition*** from the foreign value added goods which has reduced the volume of her foreign trade. There is availability of higher standard goods at lower prices in international market. It causes reduction in Rwanda's exports, which result in deficit in BOP.
6. ***Foreign debts servicing***: There is high expenditure on debt servicing since Rwanda is among the poor countries and it mostly relies on foreign resources especially through borrowing.
7. ***Importation of expensive capital goods***: For rapid industrialisation of her economy, Rwanda imports expensive capital goods in order to build her economy to build up the economy. The heavy import of machinery has considerably increased the import bill and has adversely affected her balance of payment position.
8. Most Rwandans prefer more of imported commodities than homemade commodities. This implies that Rwanda has an import oriented economy through demonstration effect leading to high demand for capital and luxurious goods. This leads to high foreign exchange expenditure which adversely affects it's BOP position.

9. The sharp rise in the prices of oil in the recent past is taking a big amount of the foreign exchange earnings. Rwanda's import bill of petroleum goods increases year after year leading to BOP problems
10. Fluctuations in the prices of Rwanda's exports: Rwanda, like any other LDCs normally exports primary products whose prices keep on fluctuating on the international market. When export prices fall, she faces BOP deficit.
11. High expenditure in production: Rwanda imports expensive capital goods which make her to produce expensively. This makes their exports expensive reducing their demand in the external markets, thus less foreign exchange earnings from them.
12. High population growth in Rwanda adversely affects her BOP position. It increases the needs for imports and decreases her capacity to export.
13. Natural calamities like bad weather reduce the yields from the agricultural sector as Rwanda's dominant export sector thus leading to adverse BOP.
14. Poor infrastructure: Rwanda has poorly developed and insufficient socio-economic infrastructure. This has led to supply rigidities thus less export volume and therefore less earnings from them.
15. Changes in fashions, tastes and preferences in the world market. This has reduced on the demand for Rwanda's exports thus adversely affecting her BOP position.
16. Unfair International Commodity Agreement (ICA): Weak ICA has less bargaining powers in the international markets leading to low export prices and low earnings from exports hence BOP deficits.
17. Insufficient export promotion institutions to promote export sector through encouraging vent for surplus in Rwanda.
18. Rwanda's economy has been hit by inflation in the recent past which has made her exports expensive leading to low demand for them in the international markets thus earning less from them.
19. Persistent depreciation of Rwanda's currency has made its products (exports) cheap while her imports are expensive and this leads to high foreign exchange expenditure.

4.4.2 Effects of BOP deficits in Rwanda

1. Rwanda's BOP deficit financed through borrowing has left little capital to spend on investment. This has left Rwanda's economy to be more unsustainable since it is burdened with high interest payments.
2. Rwanda in trying to correct her BOP deficit has attracted foreign multinationals to invest in the country or to purchase assets. This means that foreigners have an increasing claim on Rwanda's assets, which they could desire to be retained at any time. This risks her best assets to be bought by foreigners, thus reducing long term income.
3. A Balance of payments deficit has caused foreign investors to lose confidence in Rwanda. This has put Rwanda at a risk that investors will remove their investments causing a big fall in the value of her currency. This may lead to decline in living standards and lower confidence for investment.
4. A trade deficit has led to currency weakness and higher imported inflation which may worsen the BOP position further.
5. Rwanda has imported financial capital to achieve balance of payment and this in the long run may lead to capital flight in form of profit repatriation.
6. Trade deficit has led to loss of jobs in home-based industries as investors are discouraged from investing in the country.
7. Rwanda has run short of vital foreign currency reserves which has worsened the value of her local currency and this has made people lack confidence in it and resorted to investing in foreign countries. As a result, economic development has been retarded.
8. Currency weakness has led to capital flight / loss of investor confidence. This has created savings-investment gap which has called for seeking aid and grants, and its negative consequences, that hinders further long term investments in the country thus underdevelopment.
9. Trade deficit has led to lower aggregate demand and therefore slower economic growth. This is due to the fact that people are earning less from their exports which has reduced their purchasing power.
10. BOP deficit has undermined the standard of living of people in Rwanda as it has become less profitable to export, importing also has become problematic due to less earnings from trade thus worsening the standard of living of people.

4.4.3 Measures to correct adverse BOP in Rwanda

1. Labour intensive industries

Labour intensive industries should be established, because labour is cheaper in Rwanda, these industries can be set up at lower cost. The products of these industries can be exported.

2. Manufactured goods

Instead of exporting primary goods like raw cotton, coffee tea etc., Rwanda should export manufactured goods like textiles and garments, leather goods, food products and electrical goods which earn more foreign exchange. Or should process their primary products which adds value to them thus more foreign exchange earnings.

3. Reduction in export duties

This step will make our export competitive in the international market. Foreigners will prefer to import from Rwanda because of low prices.

4. Quality products

Many of our goods cannot be exported because of poor quality. Rwanda should improve the quality of its products according to international standard. This can be done by improving on technology and training of labour-force to improve on their skills

5. Export marketing

Export promotion agencies should be made more active. Rwanda has already done this. There are Export Promotion Agencies, Export Development Fund and Export Processing Zones etc. All these are playing their effective role to increase export and to correct the BOP deficits.

7. Pricing of goods

It is necessary for increasing exports that goods should be produced under optimal conditions and offered at competitive prices in international market.

8. Packing

High quality packing is essential for promoting exports. If packing is not attractive and durable, it will not capture foreign market. Thus packaging should be improved to make our exports more attractive and gain market on top of their good quality.

9. Joint venture

Establishing industries with joint venture of foreign investors can also push up the export sector. The products of these industries can be sold in the foreign market.

10. Import of only essential items

Only essential items should be imported which are needed for our industrial production. Import of luxuries should be banned. People should be educated to come out from the complex of foreign goods.

11. Exchange control

Exchange control is also an important step to minimise the imports. Exchange control should be followed, so that there is no wastage of foreign exchange to importation of un-necessary commodities and luxuries.

12. Substitutes for imported items

Import substitutes should be manufactured in the country through setting up of import substitution industries. If home production of chalk, fertilisers, paper, steel, edible oil and electrical goods are increased, there will be less need for such imports.

13. Decrease in consumption

Taxes should be imposed to reduce the consumption of many imported items. Rich people in our country are spending freely on unnecessary imported consumer items. So, foreign exchange reserves are wasted.

14. Control of smuggling

Black markets should be eliminated. The government of Rwanda should take strong and strict measures to eliminate markets of smuggled goods through anti-smuggling units.

15. Population control

Many of our problems are arising due to fast increase in population. Sincere efforts should be made to decrease population growth rate. People should be educated in this regard. This is aimed at reducing on foreign exchange expenditure on imported commodities to cater for the alarming population.

16. Infrastructural development

Rwanda should rehabilitate and develop socio-economic infrastructure to increase production and exchange of goods and services across national borders to increase foreign exchange earnings.

17. Political stability and security

Rwanda should ensure peace and security in all parts of the country so as to attract investors, exploitation of resources which increases production activities. This will increase the volume of exports and it will also reduce on the expenditure on importation of military hard ware.

Unit assessment

1. (a) To what extent is inflation a cause of the BOP problem in LDCs?
   (b) What policy measure would you suggest to reduce BOP problems in Rwanda?
2. (a) What fiscal and monetary measures may be employed to reduce inflationary pressures on the external balance of payments?
   (b) What is the relationship between the domestic economy and the balance of payments?
3. Balance of payments must always "balance". With reference to your country, explain the existence of either "favourable or unfavourable" balance of payments position.

Glossary

- **Absorption approach**: The analysis in the BOP based on comparing expenditure with domestic output.
- **Accommodating items in BOP**: The different items on the BOP account that are used to curb short term deficits.
- **Autonomous items**: Items / measures to offset a BOP surplus on the BOP account.
- **Balance of payment**: This is a relationship between a country's foreign exchange expenditure and her foreign exchange earnings in any given year.
- **Balance of payment accounts**: A summary record of a country's transactions that involve payments or receipts of foreign exchange.
- **Balance of trade**: Relationship between a country's visible exports and visible imports.
- **Balancing item**: Is one which appears in figures of BOP explaining the discrepancy between the current and long term capital account and the net change in reserves, overseas holdings and other items that make up the balance of monetary movements.
- **BB line**: A locus of levels of the interest rate and real national income for which the desired current account Balance of Payment surplus just equals the desired capital account deficit.
- **Capital account**: This refers to the record of international transactions related to movement of long and short term capital.
- **Capital movement**: Movement of money capital from one country to another.

- **Capital account**: The part of the balance of payment accounts which shows the movement of capital over a period of time.
- **Capital stock**: The total amount of physical goods existing at a particular time period which have been produced for use in the production of other goods.
- **Current account**: The portion of a balance of payments which shows the market value of a country's visible and invisible exports and imports with the rest of the world.
- **Economic sanction**: Coercive measures of an economic nature adopted in international affairs to enforce collective decisions.
- **Embargo**: Any prohibition imposed by government upon commerce or freight.
- **Exports**: Goods and services produced in one country and sold to another country. They are a source of foreign exchange.
- **Export promotions**: An outward-looking policy. It refers to deliberate government policies to expand the volume of exports.
- **Favourable balance of trade**: When the value of visible goods exported by a country is higher than that of the goods imported.
- **Import surplus**: A situation that exists when the value of imports exceeds that of imports (unfavourable trade balance).
- **Individualism**: A belief that individuals are the best judges of their own interests.
- **Official financing**: This means items that represent international transactions involving the Central bank of a country whose BOP are being recorded.
- **Price- specie-mechanism**: Automatic BOP adjustments mechanism under gold standard.
- **Trade gap**: This occurs when the quantity of imported goods exceeds that of visible exports. It is the amount by which visible imports exceed visible exports.

- **Unfavourable balance of trade**: This is when the visible goods imported by a country are greater in value than those exported.

Unit summary

- Balance of payment
  - Meaning
  - Terminologies used
  - Equilibrium and disequilibrium BOP
  - Structure of BOP accounts
  - How to offset BOP deficit or surplus
  - Causes of BOP deficit
  - Effects of BOP deficit
  - Possible solutions to BOP deficits in LDCs
- A case study of Rwanda
  - Causes of BOP deficits
  - Effects of BOP deficits
  - Policy measures to overcome BOP deficits

Topic Area 4: International Economics

Sub-Topic Area 4.1: International Trade

UNIT 5

Exchange Rates

Key unit competence: Learners will be able to analyse the various forms of exchange rate determination and their impact in economic development.

My goals

By the end of this unit, I will be able to:

- Identify the various forms of exchange rate systems.
- Examine the factors influencing exchange rate.
- Explain the impact of each exchange rate system on the economy.
- Explain the reasons and necessary conditions for successful devaluation.
- Identify the effects and limitations of successful devaluation in LDCs.
- Make comparison of the various exchange rate systems.
- Analyse the effects of exchange rate on the prices of commodities on the market in Rwanda.
- Use the conditions for devaluation to achieve economic stability.
- Justify the choice of the appropriate exchange rate system in economic development.
- Appreciate the exchange rate of Rwandan currency in terms of other currencies.
- Advocate for devaluation to increase the level of economic activities.

Activity 1

(a) Use the library, the internet or any other economics source, make more research on international trade and use your understanding and analysis to match the following currencies with their countries.

Country	**Currency**
Rwanda	Dollars
Uganda	Rwanda Francs
Japan	Shillings
USA	Yen
South Africa	Pound sterling
Britain	Rand
Denmark	Euro
European Union	Krone

(b) In your own view, what do you think foreign exchange is?

(c) Akaliza was going to visit her relatives in Canada for her December holiday, she was forced to exchange her Francs into Dollars to facilitate her travel to Canada. Why do you think she never used Rwandan francs for her travel?

(d) What ways can we may earn currencies from other countries?

(e) Carefully look at photo a, b, c, d and e. Mention the countries in which these currencies are used.

Figure 1: Foreign exchange currencies

(a)


10000 BANK OF UGANDA
BANKI NASIYONALI Y'U RWANDA
1000
BENKI KUU YA TANZANIA
3952T
1000
1000

(b)


BANK OF UGANDA 50000
50000
FIFTY THOUSAND
SHILLINGS
SHILINGI ELFU HAMSINI

(c)


5000
1000
500

(d)


2000
BENKI KUU YA TANZANIA
FEDHA HALALI KWA MALIPO YA SHILINGI ELFU MBILI
EU2061602
SHILINGI ELFU MBILI
2000
EU2061602

(e)

Facts

5.1 Meaning of Foreign Exchange

Foreign exchange is the exchange of one currency for another or the conversion of one currency into another currency. Foreign exchange also refers to the global market where currencies are traded virtually around the clock. The term foreign exchange is usually abbreviated as "*forex*" and occasionally as "*FX*." Countries in international trade use currencies other than their own. This is because not every currency is acceptable in the world market. Payment of transactions among countries is carried out in hard or convertible currencies like US dollars, Japanese Yen, pound starlings etc.

Foreign exchange *transactions* encompass everything from the conversion of currencies by a traveller at an airport *kiosk* to billion-dollar payments made by corporations, financial institutions and governments. Transactions range from imports and exports to speculative positions with no underlying goods or services. Increasing *globalisation* has led to a massive increase in the number of foreign exchange transactions in recent decades.

The global *foreign exchange market* is the largest *financial market* in the world, with average daily volumes in the trillions of dollars. Foreign exchange transactions can be done for spot or forward delivery. There is no centralised market for foreign exchange transactions, which are executed over the counter and around the clock.

5.1.1 Terms used in forex

- **Foreign exchange rate**: The rate/price at which given currencies are exchanged for each other in the foreign exchange market.
- **Exchange rate regime**: The way in which an authority manages its currency in relation to other currencies in the foreign exchange market.
- **Floating exchange rate**: A system where the value of currency in relation to others is allowed to freely fluctuate subject to market forces.
- **Fixed exchange rate:** A system where a currency's value is tied to the value of another single currency, to a basket of other currencies, or to another measure of value, such as gold.

- **Pegged float exchange rate:** A currency system that fixes an exchange rate around a certain value, but still allows fluctuations, usually within certain values, to occur.
- **Nominal exchange rate**: This is the rate at which a currency is traded for another.
- **Real exchange rate**: This is the purchasing power of different currencies i.e. how much goods and services in the domestic country that can be exchanged for goods and services in the foreign countries.
- **Spot market**: This is where the price of a currency is established on the trade date but money is exchanged on the value date.
- **Floating currency**: This is a currency that uses a floating exchange rate.
- **Forward market**: A forward market/ trade is any trade that settles further in the future than spot.
- **International currency exchange**: The rate at which two currencies in the market can be exchanged.
- **Currency exchange**: A business that allows customers to exchange one currency for another.
- **Currency pairs**: Two currencies with exchange rates that are traded in the retail.
- **Foreign exchange market**: The foreign exchange market is a market where participants buy, sell, and exchange trillions of dollars' worth of currencies daily.
- **Foreign exchange reserves:** Foreign exchange reserves are reserve assets held by a central bank.
- **Foreign exchange risk:** Foreign exchange risk is the chance that an investment's value will decrease due to changes in currency exchange rates.

5.1.2 Sources of foreign exchange

- Export of goods and services.
- Transfer payments e.g. grants and aid.
- Remittances and transfers of nationals working abroad.
- Selling of public assets abroad.
- Capital inflow through direct and foreign investments.

- Profits, dividends and interests repatriated from investments abroad.
- Funds from charitable organisations e.g. UNICEF.
- Private foreign bank deposits in the local banks.
- Borrowing from international countries, companies and individuals.

5.1.3 Factors that Influence foreign exchange rates

Activity 2

Using the library, the internet or any other economics source, research and share in your class discussion; what you think could be the factors that determine the strength of a currency over other countries' currencies in a forex market.

Facts

The foreign exchange rates, just like other financial assets, fluctuate every day as the demand and supply of different currencies changes. These changes in exchange rates affect everyone either directly or indirectly. Some of the important factors that influence the exchange rates include the following:

- Inflation rates: A country with low inflation rate compared to another country will see its currency appreciate compared to the other country. This is because, in the country where the inflation rate is low, the prices of goods and services are increasing at a slower rate. That country's exports will become more competitive thereby increasing the demand for that currency. At the same time, the foreign goods in that country will become less competitive and imports will reduce, thereby decreasing the demand for the foreign currency.
- Interest rates: A higher interest rate causes the country's currency to appreciate. This is because the country with higher interest rates can offer better rates to lenders thereby attracting more foreign capital, which causes the exchange rates to rise.

- Balance of payments: Changes in current accounts also impact the value of currency. A current account deficit indicates that the country's value of imports is more than the value of exports. Therefore, to balance the trade, it requires more foreign currency than it receives through exports. The country will therefore borrow foreign capital which will increase the demand for foreign currency and the domestic currency will depreciate. This can be changed only by either increasing exports by making the goods more attractive/competitive or by reducing imports.
- Public debt: A country with huge public debt attracts less foreign capital. This is because, high public debt leads to increase in inflation which erodes the country's currency value. Additionally, if there is a risk of default by the country, investors will sell their bond holding in the open market. This leads to a depreciation of the currency value.
- Political uncertainty and economic instability: This again is related to how foreign investors percieve the prospects of the country. If the country has high political uncertainty or economic instability, it will attract less foreign capital compared to a country that offers high stability to investors.
- Government intervention: Sometimes even the governments can intervene to artificially maintain a currency value at a certain level. For example, China has kept its currency undervalued by buying dollars so that its exports are attractive.
- Speculation: The movement in exchange rates is also influenced by the current sentiment in the market. For example; if the general sentiment is that the Euro will rise in value, the speculator will start buying Euro to make a profit causing the value of Euro to rise. Similarly, if there is speculation that a country's interest rates will rise, it will cause a lot of speculative activity in the foreign exchange market leading to the rise in currency value.

5.1.4 Forms/ types of exchange rates/ exchange rate systems/ regimes (factors influencing each)

Activity 3

There are different forms of exchange rates that may be adopted by different countries or in the same country. Visit the library, the internet or any other economics source, research and;

(a) Analyse the different types of exchange rate an economy can adopt.

(b) Explain the forms you think are adopted in Rwanda's exchange market and their likely advantages and disadvantages.

Facts

Some of the major types of foreign exchange rates are as follows:

1. The gold standard exchange rate system.
2. Fixed exchange rate system (or Pegged exchange rate system).
3. Flexible exchange rate system (or Floating exchange rate system).
4. Managed floating rate system.

1. The gold standard

Under the gold standard, a country's government declares that it will exchange its currency for a certain weight in gold. In a pure gold standard, a country's government declares that it will freely exchange currency for actual gold at the designated exchange rate. This "rule of exchange" allows anyone to go to the central bank and exchange coins or currency for pure gold or vice versa. The gold standard works on the assumption that there are no restrictions on capital movements or export of gold by private citizens across countries.

Because the central bank must always be prepared to give out gold in exchange for coin and currency upon demand, it must maintain gold reserves. Thus, this system ensures that the exchange rate between currencies remains fixed. The main argument in favour of the gold standard is that it ties the world price level to the world supply of gold, thus preventing inflation unless there is a gold discovery.

Advantages of the gold standard

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

Disadvantages of the gold standard exchange rate system

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

2. Fixed exchange rate system

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

The basic purpose of adopting this system is to ensure stability in foreign trade and capital movements. To achieve stability, government undertakes to buy foreign currency when the exchange rate becomes weaker and sell foreign currency when the rate of exchange gets stronger. For this, government has to maintain large reserves of foreign currencies to maintain the exchange rate at the level fixed by it.

Under this system, each country keeps value of its currency fixed in terms of some 'External Standard'. This external standard can be gold, silver, other precious metal, another country's currency or even some internationally agreed unit of account. When the value of a domestic currency is tied to the value of another currency, it is known as '***Pegging***'. When the value of a currency is fixed in terms of some other currency or in terms of gold, it is known as '***Parity value' of currency***'.

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

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

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

Countries can either choose a single currency to peg to, or a "basket" consisting of the currencies of the country's major trading partners.

The pegged float exchange rate can be

- Crawling bands: The market value of a national currency is permitted to fluctuate within a range specified by a band of fluctuation. This band is determined by international agreements or by unilateral decision by the central bank. Generally, the bands are adjusted in response to economic circumstances and indicators.
- Crawling pegs: This is an exchange rate regime, usually seen as part of a fixed exchange rate regimes that allows gradual depreciation or appreciation in an exchange rate. The system is a method to fully utilise the peg under the fixed exchange regimes as well as the flexibility under the floating exchange rate regime.
  It is designed to peg at a certain value but, at the same time, to "glide" in response to external market uncertainties.

- Pegged with horizontal bands: This system is similar to crawling bands, but the currency is allowed to fluctuate within a larger band of greater than one percent of the currency's value.

Advantages of a fixed exchange rate system

1. It encourages international trade by ensuring certainty and predictability of prices with goods involved in international trade.
2. It ensures stability in foreign exchange markets by avoiding constant appreciation and depreciation within the currency which ensures confidence in the domestic market.
3. It minimises speculation in the economy by both goods and foreign exchange markets and it's negative effects.
4. It reduces exploitation and cheating of foreign exchange buyers and holders by money markets and foreign exchange markets.
5. It facilitates planning since income in form of foreign exchange is assessed and predicted according to the rate of exchange.
6. The government can easily use foreign exchange rate to minimise BOP deficits i.e. by raising the exchange rate and devaluing the domestic currency which makes exports cheap and imports expensive hence improvement in the BOP position.
7. It encourages long term capital inflows in an orderly manner thus encouraging investment.
8. Central banks can acquire credibility by fixing their country's currency to that of a more disciplined nation.
9. Fixed exchange rates impose a price discipline on nations with higher inflation rates than the rest of the world. As such, a nation is likely to face persistent deficits in its balance of payments and loss of reserves.
10. Fixed exchange rate prevent debt monetisation, or fiscal spending financed by debt that the monetary authority buys up. This prevents high inflation.
11. On a micro-economic level, a country with poorly developed or illiquid money markets may fix their exchange rates to provide its residents with a synthetic money market with the liquidity of the markets of the country that provides the vehicle currency.

Disadvantages of a fixed exchange rate system

1. It is expensive to maintain because it requires a lot of foreign exchange reserves.
2. It requires strict monitoring of the economy which is affected by insufficient personnel.
3. It may lead to inflation if it is fixed above the market price or deflation if it is fixed below the market price.
4. It reduces speculation and hence reduces business profitability.
5. It discourages competition in foreign exchange markets and this leads to inefficiency.
6. The announced exchange rate may not coincide with the market equilibrium exchange rate, thus leading to excess demand or excess supply.
7. A central bank needs to hold stocks of both foreign and domestic currencies at all times in order to adjust and maintain exchange rates and absorb the excess demand or supply.
8. The cost of government intervention is imposed upon the foreign exchange market.
9. It fails to identify the degree of comparative advantage or disadvantage of the nation and may lead to inefficient allocation of resources throughout the world.
10. Fixed exchange rate does not allow automatic correction of imbalances in the nation's balance of payments since the currency cannot appreciate/depreciate as dictated by the market. It is too rigid so that the exchange rate system cannot respond to the changes in the economy. For example; when there is BOP surplus or deficit.
11. There exists a possibility of policy delays and mistakes in achieving external balance.

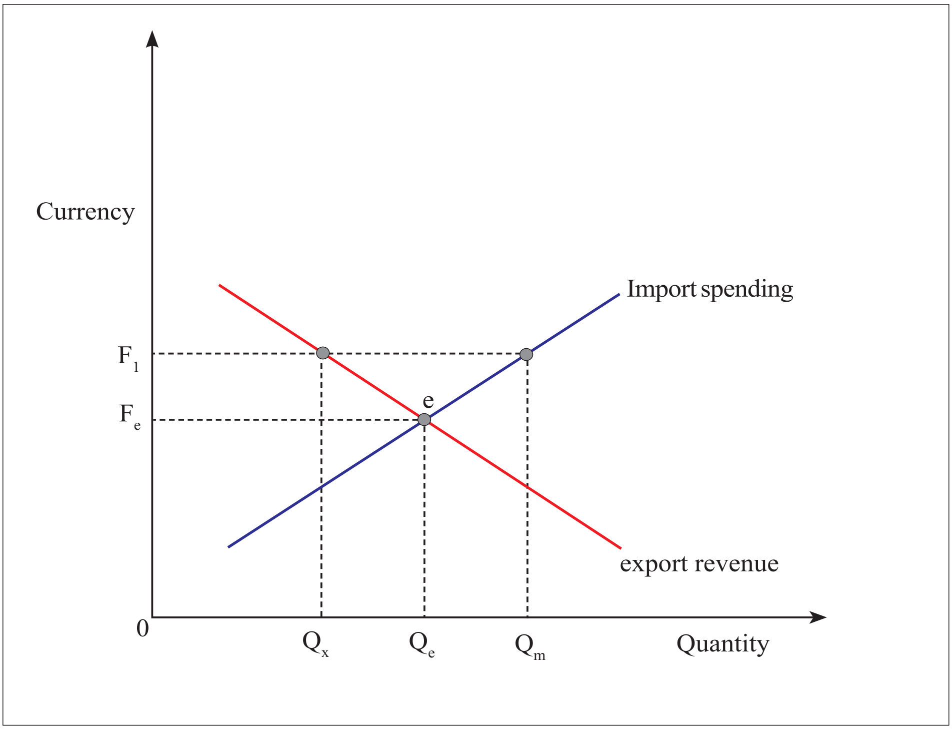
3. Flexible/floating/free/market/ fluctuating exchange rate system

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

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

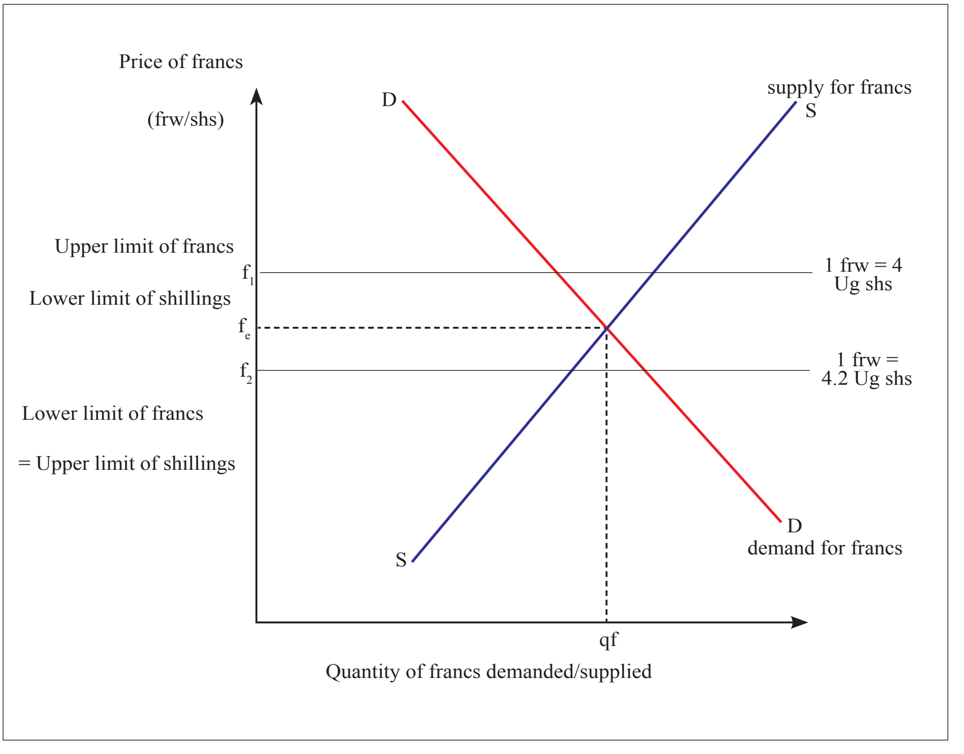
When the supply of foreign exchange is equal to the demand for it, then equilibrium exchange rate is determined.

Figure 2: Exchange rate equilibrium



From the figure above, forex equilibrium is obtained when import spending is equal to export revenue. i.e. at point '**e**' in the above diagram. This means that the demand for forex is equal to its supply. **Fe** is equilibrium currency rate while **Qe** is equilibrium quantity demanded and supplied of currencies. Below or above **Fe**, the demand for and supply of currencies isn't equal thus causing disequilibrium in the forex market (forex shortages or excess).

Figure 3: Mechanism of fixed exchange rate



From the above figure, when the exchange rate is high e.g. at $\mathbf{f_1}$, exports of the country will be cheap leading to more exports and hence leading to more supply of foreign exchange. This will lead to foreign exchange rate to fall e.g. to $\mathbf{f_2}$ and as it falls, exports will become expensive hence few exports and less supply of foreign exchange leading to scarcity of foreign exchange. This will force foreign exchange rate to rise until it reaches equilibrium foreign exchange rate where the supply of and demand for foreign exchange are equal, hence the exchange rate will be determined automatically.

In a floating exchange rate system, when the external value of the currency increases, then this is called *currency appreciation* (low exchange rate) and when the external value declines, this is called *currency depreciation* (high exchange rate)

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

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

Advantages of a flexible exchange rate system

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

Disadvantages of a flexible exchange rate system

- It creates uncertainty as it fluctuates and discourages international trade and capital movements.
- It creates instabilities in the foreign exchange rate thus affecting planning and hence discouraging economic growth and development.
- It encourages speculation in the foreign exchange where foreign exchange buyers may be cheated.

- It is inefficient in correcting BOP deficits as the domestic demand for exports and imports remain inelastic.
- It leads to fluctuations in export earnings which affects budgeting of the government.
- It discourages long term contracts between borrowers and lenders which may discourage investments and economic growth and development.
- In case there is no understanding between governments about manipulation of exchange rates, it may result into war of exchange rates with each country trying to establish favourable rates with other countries.

Causes of currency depreciation in LDCs

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

Effects of currency depreciation

Positive effects

- It increases the volume of exports hence foreign exchange earnings.
- It encourages export promotion and import substitution industrialisation which reduces foreign exchange expenditure.
- It encourages domestic investments because the cost of production is low at home.
- It reduces the BOP problems because the expenditure on imports reduces.

- It increases capital inflow and foreign investments.
- It encourages exploitation of domestic resources because it is cheaper to produce at home.

Negative effects

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

4. Managed/Dirty Floatings exchange rate system

Traditionally, International monetary economists focused their attention on the framework of either Fixed or a Flexible exchange rate system. With the end of Bretton Woods's system, many countries have adopted the method of Managed Floating Exchange Rates.

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

In this system, central bank intervenes in the foreign exchange market to restrict the fluctuations in the exchange rate within certain limits. The aim is to keep exchange rate close to desired target values. For this, central bank maintains reserves of foreign exchange to ensure that the exchange rate stays within the targeted value.

When the exchange rate rises above the upper limit, the central bank intervenes and buys off the surplus or excess foreign exchange. When the exchange rate falls below the lower limit, the central bank supplies the needed foreign exchange. However, this depends on the purpose on which the foreign exchange is needed.

Advantages of the managed floating / dirty floating exchange rate system

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

Disadvantages of the managed floating / dirty floating exchange rate system

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

5.2 Foreign Exchange Liberalisation

Activity 4

Suppose you are called upon to advise, as a person who has studied economics on the issue that; Rwanda wants to liberalise her foreign exchange market, how would you do it?

Facts

Foreign exchange liberalisation is the lessening of government regulations and restrictions in an ***economy*** in exchange for greater participation by private entities in foreign exchange market. Forex liberalisation offers the opportunity for the private sector to compete internationally, contributing to GDP growth and generating foreign exchange.

Advantages of foreign exchange liberalisation

- It reduces bureaucracy and corruption hence making it easier for investors to obtain foreign exchange.
- It encourages forex inflow because of free movement of currencies.
- It increases employment opportunities from several forex bureaus.
- Forex bureaus facilitate customers in forex transfer to and from abroad.
- It reduces over valuation and under valuation of currencies.
- It reduces government expenditure in managing the exchange rates.
- It eliminates black marketing in the forex market.
- It encourages competition in the forex market which improves service delivery.
- Forex bureaus give technical advice to customers with regard to investment and bureau dealings.

Disadvantages of foreign exchange liberalisation

- It undermines the local currency because citizens tend to prefer foreign currencies to domestic currencies.
- It results into capital outflow in form of profit repatriation in case forex bureaus are owned and operated by foreigners.
- It encourages speculation which leads to hoarding and shortages of forex.
- It leads to forex instability because of excessive competition in the forex market.
- Government loses full control over forex which may worsen BOP problems.
- It leads to misallocation of resources e.g. if scarce forex is used to import luxuries.

5.3 Foreign Exchange Reserves

Activity 5

Using the knowledge and understanding so far gained from this unit, undertake more research about exchange rates, discuss and share with the rest of the class what you think about the following:

(i) What are forex reserves?
(ii) How does Rwanda spend her forex reserves?
(iii) Does your country always get enough of the forex it always requires? Support your answer

Facts

5.3.1 Meaning of foreign exchange reserves

Foreign exchange reserves refer to the money or claims in foreign exchange, gold or Special Drawing Rights (SDRs) kept in the central bank and other international financial institutions.

5.3.2 Importance of foreign exchange reserves

- They help in stabilising exchange rates e.g. buying of excess domestic currency.
- They are used in making international payments such as national obligations abroad debt servicing.
- They are used to back the issue of local currency.
- They can be used in periods of economic hardships such as disasters, wars etc.
- They can be used to upset the BOP deficit.
- They can be used to finance foreign investments and diplomatic missions abroad.
- They can be used to purchase essential inputs or commodities.
- They are used to show the country's economic strength in international market.

5.3.3 Causes of foreign exchange shortages in LDCs

The following are the causes of foreign exchange shortages in LDCs:

- Exportation of low value primary products which fetch little foreign exchange.
- Importation of expensive commodities such as capital equipment and oil from oligopolies and monopolies.
- High marginal propensity to import due to demonstration effect.
- High foreign debt problems hence high debt servicing ratio.
- Capital outflow by multinational corporations and profit repatriation by foreign investors.
- LDCs have few investments abroad.
- Excessive employment of expatriates who are paid highly in foreign currencies.
- High population growth rates which reduce the quantity of exports and increase the volume of imports.
- A large subsistence sector which doesn't contribute to export revenue.
- Political instability and insecurity which discourage capital inflow.
- Poor government policies such as a large public sector which drains foreign exchange.
- High rates of inflation which discourages production and export.
- Protectionist policies of MDCs against LDCs products which reduces export earnings.
- Weak capital markets which do not encourage capital inflow.
- Depletion of foreign exchange reserves to finance persistent budget deficit.
- Low absorptive capacity which attracts little aid.

5.3.4 Foreign exchange control

Activity 6

The government of Rwanda, through the Central Bank of Rwanda and its monetary policy instruments, has always controlled forex in the country. From your own analysis, what do you think could be the rationale behind your government's control of foreign exchange and what are the likely effects?

Facts

Foreign exchange control means the control over the factors that determine the rate of exchange in a free and independent atmosphere. It is the state regulation excluding the free play of economic forces from the foreign exchange market. The government of a country can adopt a number of measures to control fluctuations in the rate of exchange. These measures include:

1. The establishment of official rates of exchange for the sale and purchase of foreign currencies.
2. The enforcement of regulations relating to the surrender to the government whatever foreign exchange people of a country possess.
3. Allocation of foreign exchange between people requiring it.
4. Restricting the use of domestic currency by foreigners and entering into agreement with other governments to make payments according to specified procedures for example, exchange clearing agreements.

A complete exchange control system implies subjecting all international payments to control by the government. To check the evasion of exchange control provisions, export licenses are issued to be presented to the customs officials before shipment of exports is permitted.

The term exchange control is used in two senses, namely the narrow and wide contexts. In its narrow sense, it refers to all those measures which restrict foreign exchange business; In the wide sense, it refers to all those activities of the government which influence the rate of exchange or the transactions involving payments or receipt of foreign exchange. These can be:

1. Imposition of controls on the exchange rate, on the movements of capital,
2. The management of exchange equalisation accounts, and
3. Trade and payments agreements with other countries.

Exchange control can either be full or partial. When the exchange control is full, i.e. complete, it implies that the government restricts the sale and purchase of all foreign currencies. Under the partial exchange control, the government restricts the sale and purchase of either a single currency or a few selected foreign currencies. Generally, exchange control in practice is only partial in character.

5.3.5 Rationale for exchange control

Exchange control measures may be adopted for the following reasons:

- Stabilisation: This is the most important objective of exchange control. It is geared towards ironing out temporary fluctuations in the rates of exchange. The objective should be to prevent those fluctuations of the free market rate which are purely adventitious or temporary without intervening with changes of rates which correspond to real alterations in the respective values of different currencies.
- Checking capital flight: An important objective of exchange control is to check the flight of capital from a country. Capital flight means the action of the holders of securities and bank deposits in a country to convert their cash holding into foreign exchange. If this is allowed to continue unabated, it may lead to total exhaustion of a country's scarce foreign exchange reserves.
- Ensuring availability of foreign exchange: Exchange control is also adopted to ensure the availability of foreign exchange to enable the government to import essential commodities.
- Acquiring foreign exchange to service debt: Exchange control measures are also adopted by countries to acquire foreign exchange for debt servicing and repayment of foreign loans.
- Protecting home industries: Countries also adopt exchange control measures with the objective of protecting home industries against foreign competition. In this connection, the government restricts the imports and thus provides an opportunity to the domestic industries to grow and develop without the trouble of foreign competition.
- Raising government revenue: This is done by purchasing foreign exchange at lower rates and selling it at high rates.
- Increasing economic confidence so as to attract aid and grants from international financial institutions.
- To conserve forex which can be used for strategic projects in future.
- Reducing dependence on external economies by making exchange rates for imports expensive.

5.3.6 Advantages of exchange control

The following are some of the advantages of exchange control:

- Exchange control helps in preventing erratic capital outflows.
- It helps in correcting the disequilibrium in the balance of payments by restricting imports.
- It makes the imports of essential capital goods possible by making available the needed foreign exchange.
- It helps in the prevention of imports of non-essential consumer goods.
- It aids in controlling the multiplication of foreign companies and also in regulating their operations in national interest.
- It helps in protecting domestic industries from foreign competition.
- It maintains exchange rate stability.
- It controls speculative activities in foreign exchange.
- It improves the capacity of the government to repay its external loans.
- It acts as a source of revenue for the government.
- It conserves foreign exchange which can be used to meet strategic, defense and planning needs of the country.
- It acts as an instrument of anti-deflationary policy.

5.3.7 Disadvantages of exchange control

Exchange control is associated with the following disadvantages among others:

- Exchange control reduces the volume as well as the value of international trade by restricting imports and by the restriction of exports owing to the retaliation by other countries.
- It creates inefficiency, red tape and corruption among people connected with its administration.
- It entails huge expenses because many people have to be employed for its smooth functioning.
- It leads to inequities because in some cases the restrictions are very low from which some countries gain more while in other cases the restrictions are heavy, resulting in smaller gains for some countries.
- It gives rise to smuggling and the creation of 'black markets' in foreign exchange.

5.4 Devaluation

Activity 7

Analyse the extract below, use it to undertake research on foreign exchange and answer the questions that follow.

China has been accused of practicing a quiet currency devaluation, trying to make itself a more dominant force in the trade market. Some accused China of secretly devaluing its currency so it could revalue the currency after the 2016 presidential election and appear to be cooperating with the United States. However, after assuming office, U.S. President Donald Trump threatened to impose tariffs on cheaper Chinese goods partly in response to the country's position on its currency. Some fear this may lead to a trade war, putting China in a position to consider more aggressive alternatives if the U.S. were to go ahead.

https://www.investopedia.com/terms/d/devaluation.asp

Required:

a) What is meant by currency devaluation?
b) Why do you think China devalued her currency?
c) Why do you think the US president threatened to impose tariffs on Chinese goods after devaluing her currency?
d) Under what conditions might China have based on to devalue her currency?
e) What impact does currency devaluation have on the devaluing country and the trading partners?
f) According to the extract, do you think China succeeded in her devaluation drive? Support your answer.

Facts

5.4.1 Meaning of devaluation

Devaluation refers to deliberate government policy of reducing the value of domestic currency in the face of external country's currency i.e. the domestic currency becomes cheaper in relation to other countries' currencies.

Devaluation is only possible under the fixed exchange rate system. It takes place when there is fundamental disequilibrium in the balance of payment. The devaluating country has no supply rigidities but it is facing marketing difficulties.

5.4.2 Why LDCs devalue their currencies

LDCs devalue their currencies due to the following reasons:

- To make exports cheap and hence lead to more export, there by leading to increase in foreign exchange earnings.
- To collect balance of payment problems by reducing imports by making them expensive. This is because importers need more of the local currency in order to obtain forex. Thus they either have to import less or charge high prices so that low quantity is demanded.
- To attract foreign and domestic investors as it becomes cheaper to invest in the economy as little forex can be exchanged for a lot of the local currency. Again due to devaluation there is export promotion leading to increased market for output produced by investors.
- To protect domestic infant industries from competition by cheap imports by making similar imports expensive.
- To promote self-sufficiency by encouraging import substitution industries and reduce dependency on imports from other countries.
- To conserve foreign exchange as it discourages imports and minimises foreign exchange outflow and therefore can reduce on the problem of trade shortage.
- To increase on the level of productivity and thus domestic resource utilisation. This calls for employment of idle resources.
- To increase on employment opportunities at home through increased domestic production.

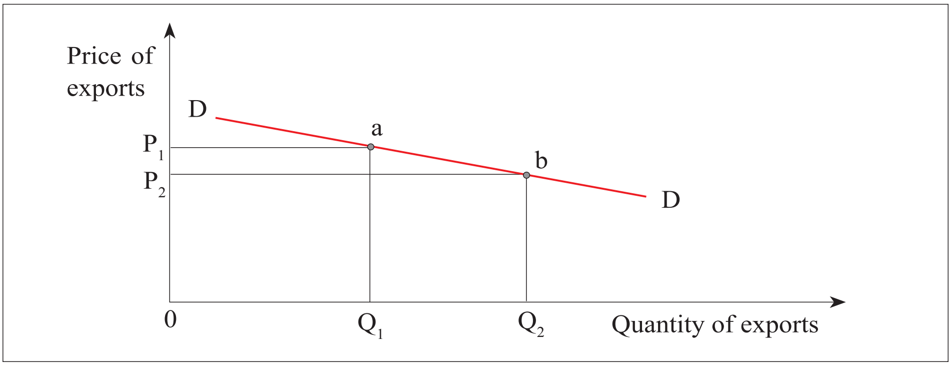
- Some LDCs undertake devaluation in order to fulfill IMF conditionalities in order to receive loans.
- To check on imported inflation because after devaluation, inflation hit imports and they become too expensive. This discourages importers.
- To increase the nominal income of the producers of primary products that are exported.

5.4.3 Conditions necessary for devaluation to be successful

A number of conditions have to be made for devaluation to be successful

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

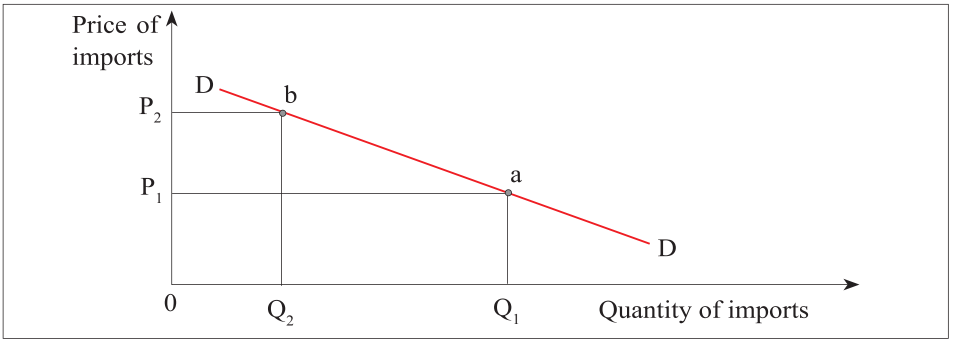
Figure 4: Devaluation and foreign exchange earnings



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

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

Figure 5: Devaluation and foreign exchange expenditure



From the figure above, before devaluation, the price for imports was OP_1 and the quantity imported was $\mathbf{OQ_1}$. After devaluation, the price for imports increased from $\mathbf{OP_1}$ to $\mathbf{OP_2}$ and the quantity demanded of imports fell from $\mathbf{OQ_1}$ to $\mathbf{OQ_2}$ thereby reducing the forex expenditure from $\mathbf{OP_1aQ_1}$ to $\mathbf{OP_2bQ_2}$. Rectangle $\mathbf{OQ_2bP_2}$ is smaller than rectangle $\mathbf{OQ_1aP_1}$.

- The supply of export in the devaluating country should be elastic such that as demand for exports increases, more quantity of exports should be supplied.
- The supply of imports should be price elastic in that when there is devaluation and there is a decrease in demand for imports, the quantity supplied for them should be able to reduce greatly.
- There should be no inflation in devaluing country so that after devaluation, exports will be cheap and attractive to foreign importers hence more will be imported.
- There should be no restrictions on exports from the devaluing countries otherwise this would limit exports and hence earnings from exports.
- There should be no counter devaluation or other countries should not retaliate by devaluing their currency because this will neutralise the intention of devaluing countries.
- There should not be trade union to put pressure on wages and increase the cost of production.
- There should be excess capacity in devaluing country such that as exports are produced, imports are discouraged and more output is produced to substitute import.

- The marginal propensity to import in devaluing country should be low..
- The devaluing country should be able to compete favorably in the world market.
- The devaluing country should be politically stable so as to ensure stable production.
- There should be stability in the exchange rate system i.e. fixed exchange rate regime.

5.4.4 The Marshall-Lerner devaluation condition

The M-L condition examines the *price* elasticities of *demand* for exports and imports of a particular country, for example Rwanda experiences **a** *depreciation* of its currency, If *foreigners' demand for exports* from Rwanda is relatively elastic, then a slightly weaker franc should cause a dramatic increase in foreign demand for Rwandan output, causing export income in Rwanda to rise dramatically. On the other hand, if *Rwanda's demand for imports* is highly price elastic, then a slightly weaker franc should likewise cause Rwanda's demand for imports to decrease drastically, reducing greatly Rwanda's expenditures on imports. If the combined elasticities of demand for exports and imports is *elastic* (i.e. the co-efficient is greater than 1), then a depreciation of a nation's currency will *shift* its current account towards *surplus*. This is the Marshall-Lerner Condition.

Marshall-Lerner Condition: If PEDx + PEDm > 1*, then depreciation or a* devaluation *of a nation's currency will shift the balance on its current account towards surplus.*

What if the Marshall Lerner Condition is not met? Demand for exports and imports may not always be so responsive to changes in exchange rates. Imagine a scenario where a weaker Franc does little to change foreign demand for Rwanda's output. In this case income from exports may actually decline (in real terms, since the Franc is weaker) as the Franc depreciates. Likewise, if Rwanda's demand for imports is highly inelastic, then more expensive imports will only minimally affect Rwanda's demand for imported *goods*, in which case expenditures on imports may actually rise as they become more expensive. In this case, where the elasticities of demand for exports and imports are highly inelastic, a depreciation of the currency will actually *worsen* a *trade deficit*. Rwanda's import expenditures will go up while export income from abroad will decline shifting the current account further into deficit.

5.4.5 Effects of devaluation

Positive effects

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

Negative effects

1. It worsens the balance of payment position because external market for LDCs products is poor.
2. It leads to imported inflation since devaluation increases prices of imports yet imports in LDCs have inelastic demand.
3. It leads to capital flight by nationals because they will tend to invest outside to earn high value foreign currency.
4. Due to inflation that may result from devaluation imported inputs become expensive which discourages production yet LDCs heavily depend on imported capital.
5. It increases borrowing rate and debt servicing burdens by LDCs since they need a lot of income in terms of domestic currencies in form of foreign resources.

6. It leads to persistent government budgetary deficit as a result of increased expenditure on imports which increases expenditure due to devaluation that makes import expensive.
7. Saving levels can decline in economy because liquidity preference to meet high price of imported commodities thus causing inflation.
8. It affects fixed income earners because where as prices are increasing due to devaluation their income remains constant hence low real incomes.
9. If it is common, it may discourage investors who lose confidence in the local currency.
10. It may reduce the standards of living of people due to shortage of commodities in the economy as a result of restricting imports yet LDCs heavily depend on imports.
11. It also discourages competition by protecting infant industries which may provide low quality commodities yet charging high prices.
12. It may hinder technological transfer because of the increase in the cost of imported commodities.

5.4.6 Success of devaluation policy in LDCs

Circumstances under which the policy of devaluation may not achieve its objectives in LDCS.

This is a policy, which some countries would prefer to adopt in order to gain from international trade, sometimes this policy may not achieve its objectives due to the following;

When country's exports have inelastic demand. Devaluation may aim at making exports cheaper so as to increase on its quantity demanded, but this may not be successful when exports have inelastic demand. When prices for exports reduce, the quantity demanded may only increase by the small percentage which fails the objective of the policy.

When country's imports have inelastic demand. Devaluation may aim at making imports expensive and discouraged but when imports have inelastic means that an increase in prices may only lead to small percentage reduction in the volume of imports thus failing to achieve its objectives.

When a devaluing country has inflation.

When the general prices of goods and services increase in the country, this also makes the prices of a country exports to increase, which can also lead to reduction in the amount demanded of the country's exports yet devaluation aims at making them cheaper and encouraged.

When other countries producing similar goods also devalue.

A country may devalue her currency with an intention of making her exports cheaper and encouraged as the way of out competing other competing countries producing similar products, but if such countries also devalue at the same time, this will increase competition among countries which can reduce the profits of a country devaluing.

When devaluing country is not the major exporter.

If the country is not the major exporter, even after devaluation her amount of exports demanded may not increase simply because other countries are much more interested in buying their products from the major exporters but not minor ones, which makes the country to fail in its objectives of devaluation.

When devaluing country produces poor quality goods.

All countries are interested in carrying out their trade with other countries that produce high quality products. The country may devalue with an objective of making her exports cheaper and encouraged but if the products are of poor quality then the amount of exports demanded may not increase after devaluation hence failing to achieve its objectives.

When there is smuggling in a country.

A country may devalue purposely with an aim of making imports very expensive and discouraged, but if there is smuggling habit , the objectives devaluation policy may not be successful because through such practices imports become so much cheaper since there are no tax charges on such goods.

When exchange rate is not fixed.

When a country devalues, it means that the exchange rate will favor her exports so that more may be demanded, but if it is not fixed, it also means it may also increase and then make exports more expensive instead and discouraged yet devaluation aims at making exports cheaper and encouraged.

When there is beggar my neighbor. Policy.

Devaluation may fail because when a country devalues and then another trading partner also adopts the same policy which increases the competition and reduces profits of a country.

When there is no strong administrative control.

Devaluation like any other policies requires a lot of commitment from the government in order to ensure its implementation and effectiveness, but if the country doesn't have strong administration toward that policy, it may not be not achieve its objectives.

When there is weak export promotion institution.

Since the policy aims at making exports cheaper and encouraged this means that a country has to establish strong export promotion institutions so as to increase on the country demand for exports, but if there is weak institutions this means that the objectives of devaluation may not be achieved.

Unit assessment

1. (a) When and why is devaluation carried out?
   (b) How is devaluation of a currency supposed to cure an economy's balance of payments current account deficit?
2. (a) Given that exchange rate is 1US $=850 Rwf. Calculate the new exchange rate after devaluation of the francs by 20%.
   (b) Under what circumstances may devaluation fail to solve the balance of payments problem in an economy?
3. Explain how fluctuations in exchange rates can effect an economy.
4. Compare the prices above before and offer the changes. Deliver a suitable conclusion

Glossary

- **Appreciation**: An increase in the value of a currency against other currencies under a floating exchange rate system.
- **Bureau de change**: A business whose customers exchange one currency for another.
- **Competitive devaluation**: A situation where several countries devalue their currencies in an attempt to gain a competitive advantage over one another.
- **Currency pair**: The quotation of the relative value of a currency unit against the unit of another currency in the foreign exchange market.
- **Digital currency exchange**: Market makers which exchange fiat currency for electronic money.
- **Depreciation**: Capital consumption wearing out of capital stock during production. It is the cost of replacing equipment worn-out in production.
- **Devaluation**: Reduction in the official exchange rate, which results into the reduction of the price of domestic currency to the foreign countries and increase in the price of the foreign currency.
- **Exchange control**: Government regulations relating to the buying and selling of foreign exchange. It is normally in order to prevent a worsening balance of payments position.
- **Exchange rate**: A price of one national currency in terms of another.
- **Fixed exchange rates**: System in which exchange rates between trading countries are pegged at a certain rate. It is maintained through reserve flow, action by the central banks, and domestic inflation or deflation.

- **Floating exchange rate**: Flexible exchange rate; a situation in which a country's foreign exchange rate is determined entirely by the market of the forces of supply and demand for currencies, without intervention by central banks or governments. The result is usually much greater fluctuations in exchange rates than under a fixed exchange rate.
- **Foreign exchange**: These are claims on a country by another country. Foreign exchange system enables one currency to be exchanged for another. Or a transaction involving exchange of one currency for another at a specified exchange rate.
- **Foreign exchange company**: A broker that offers currency exchange and international payments.
- **Foreign exchange controls**: Controls imposed by a government on the purchase/sale of foreign currencies.
- **Foreign exchange market**: This is a market where foreign currencies are traded at a price that is expressed by the exchange rate.
- **Foreign exchange rate**: The rate, or price, at which one country's currency is exchanged for the currency of another country. A country has a fixed exchange rate if it 'pegs' its currency at a constant, predetermined exchange rate, and then stands ready to defend that rate. An exchange rate which is not fixed is said to 'float'.
- **Foreign reserves**: Stock of foreign currencies and Special Drawing Rights (SDRs) held by the county's Central Bank as both reserve and a fund from which international payments can be made.
- **Foreign exchange risks**: These are risks that arise from the change in price of one currency against another.
- **Gold standard**: Is when and where the currency of a country is completely backed by gold.
- **Gold standard currencies**: These are defined in terms of a given weight of gold. Exchange rates remain fixed.

- **Managed floating exchange rates**: Determination of foreign exchange rates by the interaction of supply and demand modified on occasion by government intervention for domestic, political and economic progress.
- **Par exchange rate**: This is a price of one country's currency in terms of another by IMF.
- **Parallel exchange rate**: This occurs when the official exchange rate does not reflect the true market rate, such that unofficial exchange rate tends to operate side by side with the official one.
- **Purchasing power parity**: A situation when the exchange rate between two currencies is such that the equivalent amounts of the currencies have the same purchasing power in their respective countries.
- **Retail foreign exchange platform**: Speculative trading of foreign exchange by individuals using electronic trading platforms.
- **Revaluation**: It is the increase in the official exchange rate. It has the effect of increasing the price of the domestic currency to the foreigner and decreasing the price of foreign currency.

Unit summary

- Exchange rate
    - Meaning
    - Terms used
    - Forms of exchange rate
    - Factors influencing exchange rate
    - Advantages and disadvantages of each exchange rate system
    - Exchange rate regime (floating vs fixed exchange rate)
- Devaluation
    - Meaning
    - Reasons for devaluation
    - Conditions for successful devaluation
    - The Marshall-Lerner devaluation condition
    - Effects of devaluation
    - Success of devaluation in LDCs

Topic Area 4: International Economics

Sub-Topic Area 4.1: International Trade

UNIT 6

Economic Integration

Key unit competence: Learners will be able to explain the importance of an economic integration on the development of his economy.

My goals

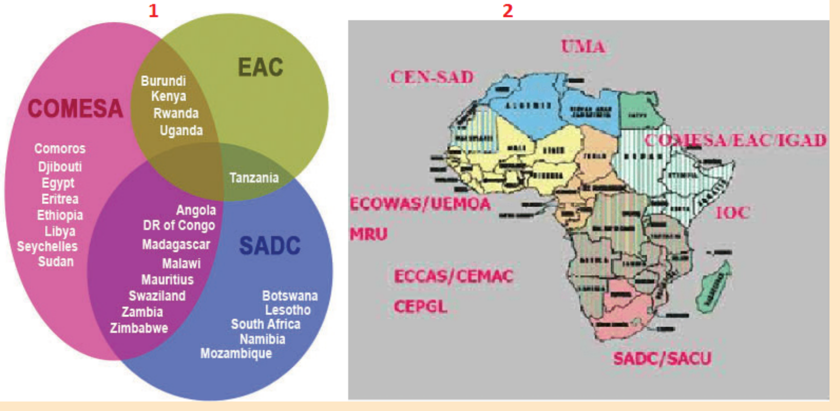
By the end of this unit, I will be able to:

- Explain the reasons why countries integrate and the likely disadvantages.
- Identify the steps taken in economic integration.
- Examine the obstacles to economic integration in LDCs.
- Identify different economic groupings in which Rwanda belongs.
- Analyse the conditions for successful economic integration.
- Discuss the advantages, disadvantages and the problems of an economic integration.
- Analyse the contribution of economic groupings on Rwandan economy.
- Acknowledge the importance of economic integration in economic development and participate willingly in the integration process.

Activity 1

Analyse the images and extract below to aid your research and thereafter answer the questions that follow.

Figure 1: Economic integration images.



Rwanda has made much progress towards integrating into the world economy, with yearly export growth rates close to 20%. However, largely because of being landlocked, Rwanda is still isolated from many trading partners and, because of the low share of trade in GDP, exports do not contribute much to overall growth. In its Vision 2020, the GOR decided to push for the "Promotion of Regional Economic Integration and Cooperation" ……….
https://bit.ly/2XAjKyO

Required:

a) What do the extract and the images portray?

b) What do you understand by the term economic integration?

c) Identify, from the images, the economic groupings in which Rwanda belongs.

d) Why do you think your country decided to push for the "Promotion of Regional Economic Integration and Cooperation" as seen in the extract above?

e) What is the basis of economic integration by the integrating countries?

Facts

6.1 Meaning of Economic Integration

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

OR

Economic integration is the coming together of countries in a given region so as to promote trade and enjoy economic benefits by working collectively. It is aimed at increasing the share of member countries in international trade as a means of achieving political harmony amongst themselves and also to consolidate their influence in international or global politics.

Examples of economic integration

- East African Community-EAC,
- Common Market of East and Southern Africa-COMESA,
- Oil and Petroleum Exporting Countries- OPEC,
- Southern Africa Development Community (SADC),
- Economic Community for West African States-ECOWAS,
- European Union-EU,
- African Union- AU,
- African Caribbean Pacific Countries (ACPC)
- Economic Community of the Great Lakes Countries (CPGL) etc.

6.1.1 Objectives of economic integration

Economic integration refers to the coordination of national economic policies as a means of boosting international trade, market activity and general cooperation among economies. Formal international economic unions are a recent phenomenon, but former International Monetary Fund economic counselor Michael Mussa traces the roots of global economic integration to the medieval era. Despite the fact that the general aim of making trade flourish remains the same, particular objectives of economic integration agreements have changed to correspond to modern political and economic circumstances.

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

6.1.2 Conditions necessary for successful economic integration

The following are conditions necessary for successful economic integration

- Geographical proximity i.e. countries coming together into an integration should be geographically close to one another or should share common boarders in order to effect preferential treatment to each other.
- Common and same ideology i.e. they should have common historical background and ideology so as to harmonise their social economic policies e.g. socialism, capitalism and mixed economies.

- They should be at the same level of development so as to ensure fair flow of resources otherwise resources would flow from less developed countries to developed countries.
- There should be strong political will or similar political organisation among cooperative countries i.e. commitment by leaders and their population.
- Countries should be preferably of equal size because there is a likelihood of them having unequal quantities of resources.
- The economies of the countries should be competitive in nature i.e. potential of producing different products so that exchange is promoted.
- There should be production of diversity of commodities thus specialisation and exchange.
- Citizens in the cooperative countries should have enough income so as to promote adequate market for commodities.
- There should be political stability among cooperative countries so as to ensure smooth operation of the regional activities.
- There should be a well-developed infrastructure in all cooperative countries.
- Countries should be complementary to one another so as to exchange their commodities.
- There should be a common language in the region.

6.1.3 Process/ stages/ levels of economic integration

Activity 2

For countries to fully integrate; they must pass through different levels of economic integration. Most economists regard an economic integration as “not a single day process” it requires a lot of efforts and a number of stages are involved.

Required:

Undertake research from any economics resource about economic integrations and answer the following questions.

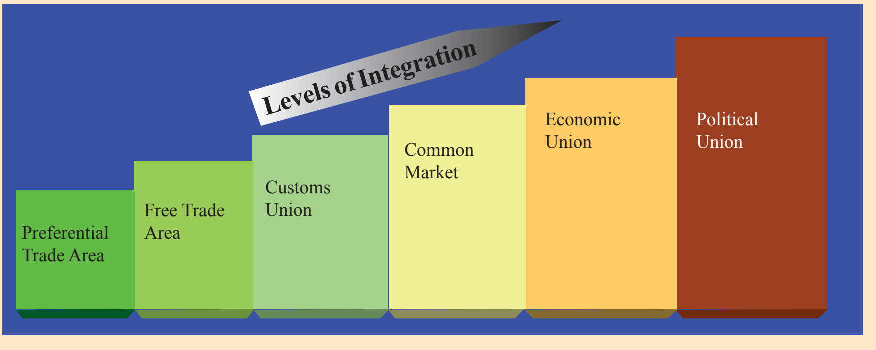
a) Why do you think economic integration is regarded as "not a single day process" by most economists?

b) Describe how you understand the journey of economic integration.

Facts:

Economic integration is not a single day process, it's a long-time journey from the day it was thought of, up to the point it takes the highest level (though it doesn't mean its end), we would call it the last stage of integration. Therefore, it's a gradual process that takes different stages which don't have a clear demarcation, but depends on how committed and willing the integrated economies are to achieve their expected goals. Stages of integration include among others the following

Figure 3: Levels of economic integration



Facts

Economic integration is not a single day process, it's a long time journey from the day it was thought of, up to the point it takes the highest level (though it doesn't mean its end), we would call it the last stage of integration. Therefore, it's a gradual process that takes different stages which don't have a clear demarcation, but depends on how committed and willing the integrated economies are to achieve their expected goals. Stages of integration include among others the following:

1. Preferential Trade Area (PTA) This is the initial level in the development of economic integration where countries start their cooperation. In here, member countries give preferential treatment to each other. There are low tariffs charged on selected commodities from member states while high tariffs are charged on commodities from non-member states. This is often the first small step towards the creation of a trading bloc. Agreements may be made between two countries (bi-lateral), or several countries (multi-lateral).
2. Free Trade Area (FTA): Here member countries abolish or eliminate tariffs or trade barriers among themselves but each country retains a separate tariff structure on commodities from non-member states.
3. Custom union (CU): This is where member countries eliminate all tariffs or trade barriers amongst themselves and in addition countries adopt a common tariff structure on commodities that are from non-member countries but there is no free flow of factors of production among member countries.
4. Common market (CM): In here, member countries eliminate trade barriers amongst themselves; charge a common tariff on commodities from non-member countries and allow free mobility of factors of production within the region e.g. capital and labour. This is done to boost production, increase employment and increase reward for factors of production and improve economic welfare in the region.
5. Economic Community/Union (EC/EU): This is where there is eliminating of all tariffs among member states, adoption of a uniform tariff structure on commodities from non-member countries; free mobility of factors of production within the region; adoption of harmonious economic policy where countries in the same region have the same economic strategy, use the same policies and policy tools. At this level, member countries have joint ownership of enterprises and they use the same currency thus have the monetary unions, harmonised social services like education, health etc. Their level of political identity is increased and thus formation of political federation.

6.1.4 Advantages and disadvantages of economic integration

Activity 3

Undertake research from the library or the internet and with reference to the extract and images in activity 1 of this unit, where you have seen that the GoR, in its Vision 2020, decided to push for the "Promotion of Regional Economic Integration and Cooperation;

a) Examine the benefits and costs faced by the Rwandan economy as a result of joining the different economic integrations.

b) Do you predict the success of such economic integrations in which Rwanda belongs? Support your view.

Facts

As a country joins different economic groupings, it is very much expectant to achieve its goals and benefit from them. These benefits include among others the following:

1. Trade creation effect: This is where the creation/formation of the economic cooperation results into a shift from consumption of expensive products from non-member countries to consumption of cheap products in member countries.
2. Expansion and extension of large markets: Most economic integration provides sufficient wide export markets since member countries have to import within the region which therefore boosts production and promote rapid economic growth.
3. Skill development and technological transfer i.e. due to free mobility of factors of production, it facilitates skill development and technological transfer within cooperative countries.
4. It increases the bargaining power of member countries in the international market, therefore this increases their benefits from the international trade.
5. It increases the competition which leads to high productivity in terms of quantity and quality.

6. It facilitates specialisation based on comparative cost advantage i.e. countries avoid competition in the production but instead specialise on the basis of comparative advantage which boosts production hence more volume of exports.
7. Sharing of common services like research, education health transport and communication etc. which are usually efficient since they are jointly operated thus reduction of duplication of services.
8. It promotes industrialisation among member states by establishing manufacturing industries.
9. Common currency is used and each state adopts a common currency and it is strong and always stable which stabilises prices in the region.
10. There is creation and expansion of employment opportunities and reduction of unemployment among member states due to the flow of factors of production freely amongst themselves.
11. It enhances political harmony and stability in the region i.e. common political problems can be solved through consultation and sharing of ideas.
12. It helps in redistribution of income in the region i.e. economic integration fosters a more equitable distribution of resources when factors of production are allowed to flow freely between or among countries thus equalising returns to each factor.
13. It reduces balance of payment deficit because economic integration leads to reduction of foreign exchange expenditure and increased export earnings.
14. It increases consumers' choice i.e. since a variety of goods are produced with in the region, countries get commodities at low prices and low costs thus maximising profits.
15. It reduces administrative costs involved in import-export restrictions.
16. It promotes self-reliance among the cooperative countries i.e. it reduces economic dependence of LDCs on MDCs.
17. It is a vent for surplus; the resources formerly un utilised can be exploited because of a wider market.

6.1.5 Disadvantages of economic integration

Much as a country expects benefits from joining different economic groupings, it should as well expect the adverse effects out of it which may include the following:

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

6.1.6 Obstacles to economic integration in Africa

Lack enough of political commitments.
There is always lack of a sustainable and stable commitment by member country governments. Some member states are not committed to the activities of the integration. Their cooperation does not go far beyond the signing of treaties and protocols. Moreover, some governments do not send to meetings those officials who have the appropriate expertise on the issues to be discussed and this hinders effective operations of economic integration.

Excessive dependency of African states on the developed countries.
Most developed countries always fight against the economic integration of developing countries due to their political and economic interests. Many African nations generally still depend on the West for imports of raw material-supplies and manufactured products. Strong economic integrations in developing countries are always threats to the markets of developed countries. This is why most developed countries always do their best against the economic integrations in developing countries so as protect their market and other political interests.

Differences in political ideologies.
It is always hard for countries to effectively integrate when they have different political ideologies. Some countries believe in democracy and other not. Political Ideological differences has always influenced the regional groupings because different governments have different conceptions as to how the goals of integration are to be fulfilled basing on their political ideology which other member states always reject.

Existence of many economic groups in developing countries.
There are many regional groupings which have been formed within Africa. A particular country may belong to more than two regional groupings. Countries in Eastern and Southern Africa belong to COMESA, SADC, and the Southern African Customs Union (SACU, whose members are: Botswana, Lesotho, Namibia, South Africa and Swaziland). With the exception of Botswana, all nine other members of SADC (Angola, Lesotho, Malawi, Mozambique, Namibia, Swaziland, Tanzania, Zambia and Zimbabwe) are also members of COMESA. Three of the five SACU members are also members of both SADC and COMESA. Almost half of COMESA members are also members of SADC, whose membership is smaller than COMESA's. This weakens the integration process. It leads to costly competition; conflict; inconsistencies in policy formulation and implementation; unnecessary

duplication of functions and efforts; fragmentation of markets and restriction in the growth potential of the sub-region.

Transport problems

There is a problem of weak and inadequate transports infrastructures for intra-Africa trade including poor roads, rail systems, air and some shipping. Even some countries like Burundi, Comoros, Lesotho, Mauritius, Rwanda and Somalia, for instance, have no yet developed their railway systems. When it comes to some road networks especially in war-torn states such as Mozambique, Angola, Democratic Republic of Congo and Burundi need urgent rehabilitation and upgrading. It is such problems of poor road network systems that hindered many developing countries to effectively forming economic integration.

Different stages of development:

Some countries in Africa are economically more advanced than others. Economic integration works on the promise that the benefits of integration will be equally distributed among member states. However, the economic benefits of the integration may end up going on only one side to countries which are more advanced because of having bigger investments in different sectors than other. It is always such fears that hinder countries to form economic grouping.

Unfavorable exchange rate system.

Some countries have currencies which have more value than others. When the values of currencies are different, this means that the exchange rate may be in favour some countries and disfavour others. If a country's exchange rate is high this also means that her exports to other countries will be so expensive and imports from other countries may be so cheap, so this may be a dis advantage to other countries with in the integration.

Differences in cultures.

It is always very hard for countries to integrate successfully when people totally have different cultures. Sometimes differences in cultures has been given as an excuse for the failure of some economic integration in developing countries. Culture means a lot towards people's cooperation, so when it is totally different it means there are some stages of cooperation which countries may not be able to reach at hence being an obstacle.

Production of similar products. It is totally hard for the integrated countries to reach higher stages of the economic integration simply because of producing similar products which makes it hard for countries to benefit from each other as it is always intended for thus being a big obstacle.

Need for self-reliance. Some countries may refuse to integrate with others because of their need for self-reliance. Regional integration requires a country to sacrifice some of her national interest for the sake of the region like self-reliance in order to effectively cooperate with other countries which some countries fail to meet.

Difference in fiscal and monetary policies. It is very hard for countries to integrate if their monetary and fiscal policies are totally different. Some countries fail to effectively cooperate with others simply because of differences in their tax structures and of which not favouring them

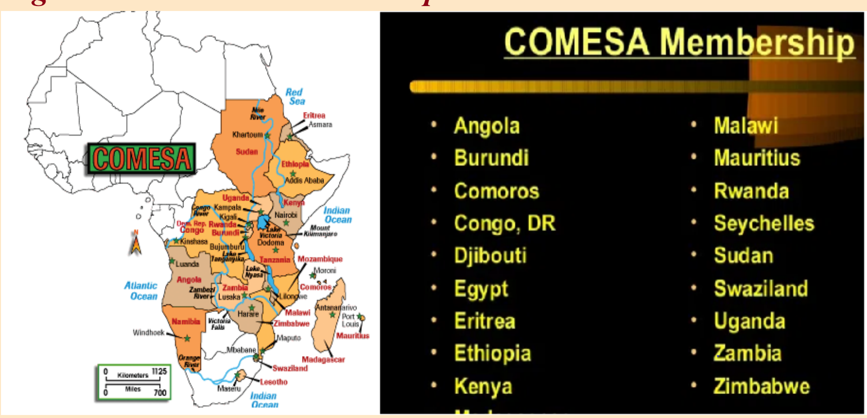
Differences in geographical boundaries.
Sometimes it becomes hard for countries to integrate successfully if they are not near each other because this makes transportation of goods so costly and very hard.

6.2 Case Studies of Economic Integrations

6.2.1 Common Market for Eastern and Southern Africa (COMESA)

Activity 4

Figure 4: COMESA Membership



A B

With reference to the images above, visit the library, the internet or any other economics source and research on COMESA and share with the class about the following:

(i) The countries that make up COMESA.
(ii) The objectives behind COMESA formation.
(iii) The achievements and challenges of COMESA.
(iv) What Rwanda has benefited from COMESA.

Facts

COMESA is the largest regional grouping in Africa, in terms of the number of member states — it claims 21 members, almost half of the total number of countries in Africa. It has about half of Africa's total population. COMESA member states resolved to promote the integration of the Eastern and Southern African region through trade development. They also agreed to develop their natural and human resources for the mutual benefit of the COMESA region.

Member countries of COMESA

Angola, Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe.

COMESA was established in 1994 replacing the Preferential Trade Area for Eastern and Southern Africa (PTA). The PTA was created in 1981 within the framework for the Organisation of African Unity's (OAU) Lagos Plan of Action and the Final Act of Lagos.

COMESA is one of the most successful economic co-operation and integration groups in Africa. It has a proven track record of achievements being supported by its financial specialised institutions, namely the Trade and Development Bank for Eastern and Southern Africa (PTA Bank), the Clearing House and the Re-Insurance Company. The stages of integration followed by COMESA are indicated below.

Stages of regional integration followed by COMESA

- Preferential Trade Area: Trade among countries is conducted on a preferential basis, in conformity with agreed rules of origin, with each country maintaining its own tariffs on goods imported from third countries.
- Free Trade Area (FTA): In conformity with agreed rules of origin, with each country maintaining its own tariffs on goods imported from third countries.
- Customs Union: Member countries operate a common external tariff and there is free movement of goods once they enter the customs union. Tariff revenues are either shared among member countries or allocated according to the destination of the goods.
- Common Market: There is free movement of goods, services, labour and capital, and the right of establishment and residency, between members of the common market.
- Economic Community: In addition to the conditions of the common market, the economic community has a single currency issued by one monetary authority and common monetary and fiscal policies.

Objectives of COMESA

The COMESA Treaty, which sets the agenda for COMESA, covers a large number of sectors and activities. The role of the COMESA Secretariat is to take the lead in assisting its member states to make the adjustments necessary for them to become part of the global economy within the framework of the World Trade Organisation regulations and other international agreements. This is done by promoting "outward oriented" regional integration. The aim and objective of COMESA as defined in the treaty and its protocols is therefore to facilitate the removal of the structural and institutional weaknesses of member states by stages so that they are able to attain collective and sustained development. Among other things, COMESA member states agreed on a number of things.

1. A full free trade area guaranteeing the free movement of goods and services produced within COMESA and the removal of all tariff and non-tariff barriers.

2. A customs union under which goods and services imported from non-COMESA countries will attract an agreed single tariff in all COMESA states.
3. Free movement of capital and investment supported by the adoption of a common investment area so as to create a more favourable investment climate for the COMESA region.
4. A gradual establishment of a payment union based on the COMESA Clearing House and the eventual establishment of a common monetary union with a common currency.
5. The adoption of common visa arrangements, including the right of establishment leading eventually to the free movement of persons.

Figure 5: Vision of COMESA

VISION OF COMESA	COMESA IN 2016
To attain a fully integrated and internationally competitive regional economic community with high standards of living of its people and where goods, services, capital and labour freely move across borders.	• Single currency and common Central Bank • Border-less region • Free mobility of factors of production • Common investment area • Single market for primary and secondary goods • Air and ground transport fully integrated and liberalised • Common border posts

Figure 5 above shows COMESA's vision by 2018

Achievements of COMESA

The following are the achievements of COMESA

- It has increased regional trade among member states i.e. trade creation.
- It has led to establishment of joint ventures/ services like PTA Bank in Kenya and there is use of PTA cheques which have facilitated easy trade and transfer of cash.

- It has established a clearing house in Harare Zimbabwe for settling barter trade transactions. This has increased the volume of trade and has helped countries to exchange goods without foreign currencies. Only differences in values are settled in hard currencies.
- It has a chamber of commerce and industry group which organises trade fares or shows to increase market for member state products.
- There has been increase in coordination of business activities in the region by setting up a trade information network.
- There has been improvement in infrastructure such as transport and telecommunication services.
- Good diplomatic relationship has been maintained among member states.
- The PTA has increased market for commodities because of production for large market.
- In terms of communication, due to the global advances in telecommunications technology and private sector involvement, there is measurable improvement in inter-country connectivity. For example, the action by major mobile telephone service provider Airtel Company Limited (formerly Celtel), to merge its Kenyan, Ugandan and Tanzanian networks, thereby offering the first regional 'borderless' network (the tariffs for this service are substantially lower than roaming charges) in the world. This is seen as a major boost to inter regional communication. Some RECs demonstrate better connectivity (SADC, ECOWAS, COMESA, and UMA).
- Africa remains a hotbed of conflicts, some of them extremely violent. A number of RECs established to pursue economic development are largely preoccupied with peacekeeping operations.

Challenges of COMESA

Below are the challenges of COMESA

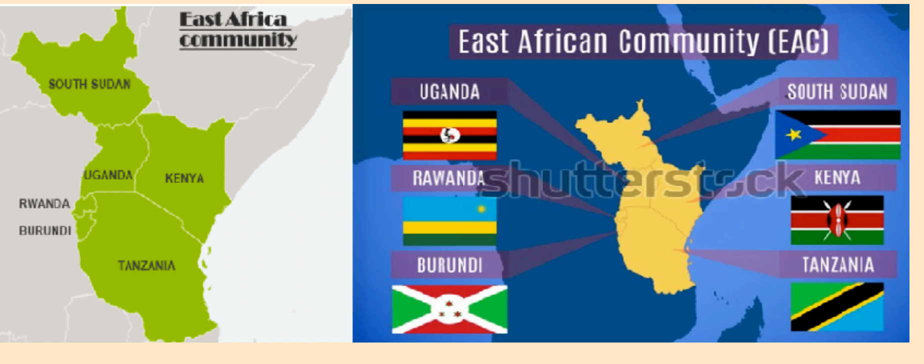
- Countries produce similar agricultural and industrial products thus exchange is difficult.
- Poor infrastructure in the PTA countries as they cannot afford to finance heavy infrastructure like the railways, roads, air transport.
- Due to differences in foreign policies, it is difficult to form a free trade area by harmonising tariffs charged on foreign countries.

- Costs of production in PTA countries is very high, thus some countries find it cheaper to import commodities from 'third countries' especially developed countries which are traditional trade partners and can sell at a cheaper price and even extend credit facilities.
- No common currency to use for the exchange of commodities.
- Most of the PTA countries are land locked, therefore if there is free movement of resources, most industries would go to countries with easy access to the harbor which would cause development imbalances.
- Political instabilities in some of the member states have interfered with the trade flows in the area.
- There are small countries like Rwanda and Burundi and large countries like Tanzania and Sudan, therefore benefits are likely to flow to large countries where there is a diversity of opportunities and a high population to absorb those opportunities.
- The difference in administration, customs, posts and telecommunication, railways, harbors, research etc. lead to difficulty in movement of people, commodities and information among countries.
- Significant progress in integration is limited by the inability or unwillingness to prevent and decisively resolve numerous conflicts across the member states.

6.2.2 East African Community (EAC)

Activity 5

Figure 6: EAC images



With reference to the images above, visit the library, the internet or any other economics source and research on EAC. and share your views in the class about the following:

(i) The countries that make up EAC.
(ii) The objectives behind EAC. formation.
(iii) The achievements and challenges of EAC.
(iv) Reasons why Rwanda joined EAC
(v) What Rwanda has benefited from EAC.

"EAC motto: one people, one destiny"

Achievements of EAC

- **Joint interventions for food security** in the region by operationalizing the EAC Industrialization Policy and Strategy for value addition in agricultural products.
- **Developed and operationalized the EAC climate change policy and strategy** that provides for mitigating negative effects of climate change on agriculture and food security.
- **Developed the EAC Food and Nutrition Policy.** Coordinated the harmonization and the registration of immunological and use of veterinary products in the region through Mutual Recognition Agreements (MRAs) to ease access to veterinary services and animal disease control in the region.
- **Joint developments of regional Infrastructure.** The regional infrastructure projects are cross cutting within the EAC integration pillars and the achievements are the Formulation of the EAC Vehicle load control Act 2016 which harmonizes Gross Vehicle weights to 56 tones under seven axles, and also fees charged on offenders of over loaded vehicles.
- **Promotion of foreign policy co-ordination** through collaboration in diplomatic and consular activities; collaboration in economic and social activities; liaison and exchange of information; and collaboration in administration and capacity building.
- **The partner states have adopted** an action program that has focused on **increased employment and poverty reduction in the EAC**. In this regard, the EAC projects and programs are assessed as to how they contribute towards poverty eradication in the region. Furthermore, the

East African Community established an annual Ministerial Forum to focus on employment creation and poverty reduction.

- **One Network Area: Under the One**-Network Area the region has established a one-network area with lower calling rates of US$0.10 cents. Kenya, Uganda and Rwanda have embraced the concept with lower roaming rates for voice with no or less receiving charges.
- **Removal of Non-Tariff Barriers (NTBs):** This was done by establishment of the EAC Elimination of NTBs Act, 2017 and the National and regional committees to identify and monitor their elimination. This has reduced clearance procedures, delays at the ports of entry/exit, at weighbridges and numerous road blocks; in ferrying of cargo by transit vehicles; non-recognition of EAC Certificates of Origin; non – recognition of quality marks issued by EAC Bureaus of Standards; retesting of products among others.
- **Establishment of the EAC Single Customs Territory (SCT):** This has facilitated faster clearance and movement of cargo from the port of entry to the destination. For example, this has led to turnaround time of trucks from Mombasa to Kampala to reduce from 18 days to 4 days and to Kigali from 21 days to 6 days; real time sharing of customs information upon arrival of goods at the port; reduced documentation/ paper work currently used to release goods up to destination and simplified the administrative burden.
- **Tax harmonization** with a view to removing tax distortions in order to bring about a more efficient allocation of resources within the Community. For example, the Policy for Harmonization of Income Taxes within the East African Community" and the "Policy for harmonization of VAT & Excise duties" were developed.
- **The establishment of institutions such as the East African Legislative assembly (EALA) and the East African Court of Justice (EACJ)**. This has encouraged the exchange of students and directing staff at different military training institutions/colleges, supported joint Utilization on the Defense Technical Facilities offered for shared utilization among the EAC Armed Forces and facilitated the gathering and sharing of intelligence information within the EAC bloc.
- **Harmonization of Standards:** EAC has harmonized a total 1,428 Standards of which five hundred and seven (507) are indigenous, designated as East African Standards and the Nine hundred and twenty-

one (921) are international standards agreed upon and endorsed for adoption by the Partner States.

- **One Stop Border Posts (OSBPs):.** There has been implementation of OSBP aimed at facilitating cross-border movements through reduction of the time taken in clearance procedures. This has been facilitated through the formulation of an EAC OSBP Act 2016 which grants officers from adjourning Partner State right to implement their national laws while operating across the border.
- **Launched Lake Victoria Commission** i.e. East African partner states have taken a number of steps to preserve the lake through the implementation of the Lake Victoria Environmental Management Program. This has ensured sustainable use of Lake Victoria as vital for the sustainability of the lake.
- **Improvement of East African Infrastructure** through the East African Road Network Project where a Tripartite Agreement on Road Transport has been ratified by partner states. The main objectives of the agreement are to facilitate interstate road transport through reduced documentation for crews and vehicles at border crossing, harmonized requirements for operation licensing and customs and immigration regulations, among others. In order to fast-track decisions on transport and communications, the EAC established the Sectoral Council on Transport, Communications and Meteorology.
- **Free movement of goods, persons, labour, services and capital, and rights of establishment and residence**. This has been achieved through; Free movement of persons and labour, Reciprocal opening of border post for 24 hours, harmonized entry/ exit forms, harmonization of procedures for issuance of work permits, Student pass issued gratis; Kenya, Uganda and Rwanda have waived work permit fees, Joint promotion of Tourism.
- **Harmonization of Monetary and Fiscal Policies.** This has led to convertibility of the partner states' currencies, harmonization of banking rules and regulations, harmonization of Finance Ministries' pre- and post-budget consultations, regular sharing of information on budgets, and reading of budget statements on the same day.
- **Strengthened an East African Identity** i.e. there have been developments designed to foster the feeling of integration among the people of the EAC and to facilitate an East African identity by

introducing the East African Community flag, the launching of an East African anthem and the East African passport.

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

Facts

The East African Community (EAC) is an intergovernmental organisation composed of six countries in the African Great Lakes region in eastern Africa: Burundi, Kenya, Rwanda, South Sudan, Tanzania, and Uganda, with its headquarters in Arusha, Tanzania. John Magufuli, the president of Tanzania (2016), is the EAC's chairman. The organisation was founded originally in 1967, collapsed in 1977, and revived on 7th July 2000 following its ratification by the Original 3 Partner States – Kenya, Uganda and Tanzania.

In 2008, after negotiations with the Southern Africa Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA), the EAC agreed to an expanded free trade area including the member states of all three organisations. The EAC is an integral part of the African Economic Community.

The EAC is a potential precursor to the establishment of the East African Federation, a proposed federation of its members into a single sovereign state. In 2010, the EAC launched its own common market for goods, labour, and capital within the region, with the goal of creating a common currency and eventually a full political federation. In 2013 a protocol was signed outlining their plans for launching a monetary union within 10 years.

The EAC aims at widening and deepening co-operation among the partner states and other regional economic communities in, among others, political, economic and social fields for their mutual benefit.

Aims and objectives

The EAC aims at widening and deepening co-operation among the Partner States in, among others, political, economic and social fields for their mutual benefit. To this extent, the EAC countries established a Customs Union in 2005 and are working towards the establishment of a Common Market by 2010, subsequently a Monetary Union by 2012 and ultimately a Political Federation of the East African States.

Enlargement of the community; The realisation of a large regional economic bloc encompassing Burundi, Kenya, Rwanda, Tanzania and Uganda with a combined population of 120 million people, land area of 1.85 million sq. kilometers and a combined gross domestic product of 41 billion USD, bears great strategic and geopolitical significance and prospects of a renewed and reinvigorated East African Community.

The specific objectives of the EAC Integration are

- To attain sustainable growth and development of the partner states by the promotion of a more balanced and harmonious development of the partner states.
- To strengthen and consolidate co-operation in agreed fields that would lead to equitable economic development within the partner states and which would in turn, raise the standard of living and improve the quality of life of their populations.
- To promote sustainable utilisation of natural resources of partner states taking measures to effectively protect their natural environment.
- To strengthen and consolidate long standing political, economic, social, cultural and traditional ties and associations between the peoples of the partner states so as to promote a people-centreed mutual development of these ties and associations.
- To mainstream gender in all its endeavors and the enhancement of the role of women in cultural, social, political, economic and technological development.
- To promote peace, security, stability within, and good neighborliness among, the partner states.
- To enhance and strengthen partnerships with the private sector and civil society in order to achieve sustainable socioeconomic and political development.

- To undertake activities calculated to further the objectives of the Community, as the partner states may from time to time decide to undertake in common.

Current status

The regional integration process is at a high pitch at the moment. The encouraging progress of the East African Customs Union, the enlargement of the Community with admission of Rwanda and Burundi, the ongoing negotiations of the East African Common Market as well as the consultations on fast tracking the process towards East African Federation all underscore the serious determination of the East African leadership and citizens to construct a powerful and a sustainable East African economic and political bloc.

On 16th October 2014, the Eastern African Community (Burundi, Kenya, Rwanda, Tanzania, and Uganda) finalised the negotiations for a region-to-region Economic Partnership Agreement (EPA) with the EU.

Trade picture

- East Africa is a geographically and economically homogeneous region committed to regional integration. The East African Community (EAC) consists of Burundi, Rwanda, Tanzania, Uganda (all of which are least developed countries or "LDCs") and Kenya which is more developed than the rest.
- The EAC established a Customs Union in 2005 which was fully-fledged with zero internal tariffs as from 2010. The EAC, in fast tracking its economic integration process, ratified a more far-reaching common market protocol in July 2010. In November 2013, EAC members signed a protocol on a monetary union.
- The integration agenda of the EAC is strongly political in nature as its ultimate goal is to become a federation.
- All the countries in the East African Community are members of the WTO.
- Exports to the EU from East African Community are dominated by coffee, cut flowers, tea, tobacco, fish and vegetables.
- Imports from the EU into the region are dominated by machinery and mechanical appliances, equipment and parts, vehicles and pharmaceutical products.

Achievements of the East African Community

Here indicated below are the achievements of the East African Community

- The most important achievement was the establishment of the EAC Custom Union. The Custom Union Protocol was signed in March 2004 and came into effect on January 1, 2005.
- Under Customs Union arrangements, goods produced within the EAC move across the border of partner states without taxation provided they qualify under rules of origin.
- It has increased both inter and intra-regional trade, increased competition that has increased consumer's choice, reduction of costs, and attraction of foreign direct investments.
- It has witnessed an increase in intra-EAC foreign direct investments as well as foreign direct investments from outside.
- There is mutual recognition of standards marks across the region where the bureaus of standards have developed an EAC catalogue of standards
- It has led to establishment of One Stop Boarder Posts that have already been articulated within the auspices of the community law. This has facilitated trade within the community
- It has implemented internal tariff elimination. This has facilitated smooth trade among the states.
- As part of the joint effort to promote East Africa as a single tourist destination, partner states have participated in major international travel markets forums including the World Travel Market in London November 2005 and the International Tourism Bourse in Berlin in March 2006 which has helped in promoting East Africa as a single tourist destination and has resulted in attracting more tourists and increasing the contribution of the tourism industry to the East African economy.
- Promotion of foreign policy co-ordination through collaboration in diplomatic and consular activities; collaboration in economic and social activities; liaison and exchange of information; and collaboration in administration and capacity building.

- Launched Lake Victoria Commission i.e. East African partner states have taken a number of steps to preserve the lake through the implementation of the Lake Victoria Environmental Management Programme. This has ensured sustainable use of Lake Victoria.
- The partner states have adopted an action programme that has focused on increased employment and poverty reduction in the EAC. The EAC projects and programmes are assessed as to how they contribute towards poverty eradication in the region.

  Furthermore, the East African Community established an annual Ministerial Forum to focus on employment creation and poverty reduction.
- Improvement of East African Infrastructure through the East African road network project where a tripartite agreement on road transport has been ratified by partner states. The main objectives of the agreement are to facilitate interstate road transport through reduced documentation for crews and vehicles at border crossing, harmonised requirements for operation licensing and customs and immigration regulations, among others. In order to fast-track decisions on transport and communications, the EAC established the sectoral council on transport, communications and meteorology.
- Harmonisation of monetary and fiscal policies i.e. steps toward the harmonisation of monetary and fiscal policies have included convertibility of the partner states' currencies, harmonisation of banking rules and regulations, harmonisation of finance ministries' pre- and post-budget consultations, regular sharing of information on budgets, and reading of budget statements on the same day. In capital markets, there have been changes in the policies and trading practices and regulations in the three stock exchanges. The committee for the establishment of Capital Markets Development that oversees the development of the capital markets in the East African Community aims to develop East African community capital markets including managing cross-listing of stocks.
- Strengthened an East African identity i.e. there have been developments designed to foster the feeling of integration among the people of the EAC and to facilitate an East African identity. These have included the introduction of the East African Community flag, the launching of an East African anthem and the East African passport.

Benefits of the EAC Integration

- A wider market with a combined population of over 160million people and GDP of about US$170billion.
- Freedoms under Common Market
- Increased both inter and intra-regional trade
- Safeguarding the region from international economic shocks.
- A Common External Tariff in place to protect the community's domestic industries.
- Improved early warning and conflict resolution mechanisms.
- Construction and operationalization of One Stop Border Posts (OSBPs) where border agencies are housed under one roof for good clearance.
- Regional infrastructural development
- Harmonization of Education Standards, and mutual recognition of agreements (Engineers, Accountants, Architects, and Veterinarians).
- Joint Promotion of the EAC as a Single Tourist destination.
- Increased competition that has increased consumer's choice,
- Increased intra-EAC Foreign Direct Investments as well as Foreign Direct Investments from outside.

Challenges of the East African Community

The following are the challenges of the East African Community
Despite the progress made throughout the years, some challenges remain noteworthy and this has hampered the progress of the community;

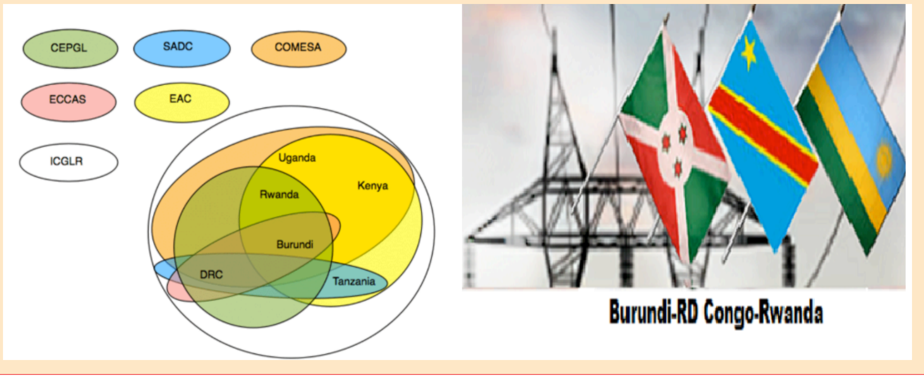
- Some citizens of some member states lack awareness of the regional integration process and cannot articulate the benefits that can be drawn from the EAC integration process. e.g. in Tanzania.
- Differences in social political ideologies amongst member states e.g. in Tanzania the social political system that was in place for over 3 decades after independence, makes people both in public and private sectors not very entrepreneurial as they tend to rely on the government
- One of the reasons for the collapse of the previous East African Community in 1977 was the perception of disproportionate sharing of economic benefits accruing from regional markets and lack of a formula for dealing with the problem. It is still a challenge to the community to address problems arising from the implementation of the treaty.

- Improving the performance of major ports such as Mombasa and Dar-es Salaam, and the East Africa road network and East Africa railway network are key challenges facing the East African Community. Improving supply conditions will enhance EAC capacity to withstand the forces of globalisation
- The EAC report on fast tracking (2004:81) reports that the fear of loss of sovereignty is an issue in the minds of some members of the political elite of East Africa. The fear is that as a Federation, the nation states would cease to have any meaningful powers; that they would be relegated to mere provinces within the Federation.
- Participation by citizens is at the core of the new East African Community. The treaty advocates for people-driven and people-centreed development. East African people should play an active role in determining the progress of the new community. The community has to live up to the expectations of the peoples of East Africa by implementing the treaty's provisions for the creation of an enabling environment for the private sector and civil society participation, the strengthening of the private sector; and enhancement of co-operation among business organisations and professional bodies.

6.2.3 Economic community of the great lakes countries (CEPGL)

Activity 6

Figure 8: CEPGL images



With reference to the images above, visit the library, the internet or any other economics source and research on CEPGL and share with the class about the following:

(vi) The countries that make up CEPGL.
(vii) The objectives behind CEPGL. formation.
(viii) The achievements and challenges of CEPGL
(ix) What Rwanda has benefited from CEPGL.

Facts

The Economic Community of the Great Lakes Countries (ECGLC) (in French **CEPG**L - *Communauté Économique des Pays des Grand Lacs*) is a sub-regional organisation with multiple vocation created by the signing of the Agreement in Gisenyi, Rwanda on September 20, 1976 under the initiative of the former president of Congo (Zaire), Mobutu. The ECGLC aimed at insuring the safety of member states, favouring the creation and the development of activities of public interest, promoting the trade and the traffic of the persons and the possessions. It aimed at establishing the cooperation in a narrow way in all the domains of the political, economic and social life.

It has three members: Burundi, Democratic Republic of Congo (formerly known as Zaire), and Rwanda. It has its headquarters in Rwanda. Its purpose is to promote regional economic cooperation and integration. The CEPGL is an Economic Community of East Africa.

The community of the Great Lakes Countries collapsed in the mid 1990's, precisely in 1994 due to conflicts within and between member states. After more than 13 years of lethargy and under the pressure of international community, the ministries council held in Bujumbura on the 17th April 2007 decided to relaunch the CEPGL activities. During the ministries council, three priorities were retained on the CPEGL agenda for the next five years (2011- 2016):

1. Peace, security and good governance
2. Energy and infrastructures
3. Agriculture and food security.

The CEPGL controls the following institutions

- Bank of Development of the States of the Great Lakes (BDEGL).
- Comité Permanent Inter-Compagnies (COPIC).
- Institute of the Agronomic Researches and Zootechniques (IRAZ).
- Economic Community of the Great Lakes Countries Organisation for Energy (EGL).
- International Society for Electricity in the Great Lakes Region (SINELAC).
- Research Centre for the Development of the Mining Resources in Central Africa (CRDRMAC).

Objectives of CEPGL

The main objectives of the Economic Community of the Great Lakes are:

4. Promotion of economic and social development among the member countries (free movement of persons, foster international trade).
5. Promotion of peace initiatives in the region (Burundi, the Democratic Republic of Congo, and Rwanda).
6. Promote strategic development in the region: Energy, Infrastructure, Agriculture, and Food Security.

Achievements of CEPGL

- Promotion of sustainable peace in the Great Lakes region of Africa by signing the MoU on 14 April 2016 at the CEPGL Secretariat in Gisenyi, Rwanda. This has led to implementation of the Cross-Border Dialogue for Peace in the Great Lakes programme in the three CEPGL member states, aiming to help build cooperation and trust between Burundian, Congolese and Rwandan citizens who can act as change agents for peace at the regional level.
- Created the International Great Lakes Energy Company (SINELAC) which exploits a hydro dam in the Congolese territory, Mumoshu in the southern Kivu province with the aim to produce and furnish electricity to members of CEPGL

- Created the Development Bank of the Great Lakes Countries (BDGL) with its headquarters in Goma (DRC) aimed at financing community projects.
- Put up the institute of agriculture and livestock research (IRAZ) which aimed at doing research in the domains of agronomy and zootechnics.
- Provided the CEPGL identity card which enables free movement of people within the community leading to the development of small cross border business from which thousands of people earn a living.
- Set up the Energy Organisation of the Great Lakes Countries (EGL) aiming at improving cooperation amongst members in the energy sector.
- Increased commercial exchange between Burundi, Rwanda and Eastern DRC. For example, products like foodstuffs, livestock, bracelet etc. are traded from Goma to markets in Rwanda and Burundi. This informal trade has great impact on everyday life of the population and its practitioners. The revenue generated by this business is significant compared to what civil servants can earn monthly in the region.
- Successfully Implemented common infrastructures and projects such as BDGL, IRAZ, SINELAC.

Unit assessment

1. (a) What are the features of an economic union?
   (b) Analyse the objectives behind economic integration by nations.
   (c) Examine the factors that may encourage formation of an economic union in eastern Africa.
2. (a) Why did the East African Community fail in 1977?
   (b) What good things can the current EAC learn from the former EAC?
3. In what ways may economic integration solve problems of underdevelopment?

Glossary

- **Economic integration**: The coming together of countries in a given region so as to promote trade and enjoy economic benefits by working collectively.
- **Trade creation**: A situation where formation of economic cooperation results into a shift from consumption of expensive products from nonmember countries to consumption of cheap products in the member countries.
- **Trade diversion**: A the shift in trade from cheap products of non-member states to expensive products of member states within the integration.

Unit summary

- Economic integration
    - Meaning
    - Reasons/ rationale for economic integration
    - Conditions for economic integration
    - Steps/ levels of economic integration
    - Advantages and disadvantages
    - Obstacles of economic integration
- Case studies
    - East African community (EAC)
    - Common Market for Eastern and Southern African (COMESA)
    - Economic Community of the Great Lakes Countries (CEPGL)

Topic Area 4: International Economics

Sub-Topic Area 4 .2: Globalisation

UNIT 7 Globalisation

Key unit competence: Learners will be able to analyse the impact of globalisation on Rwandan economy.

My goals

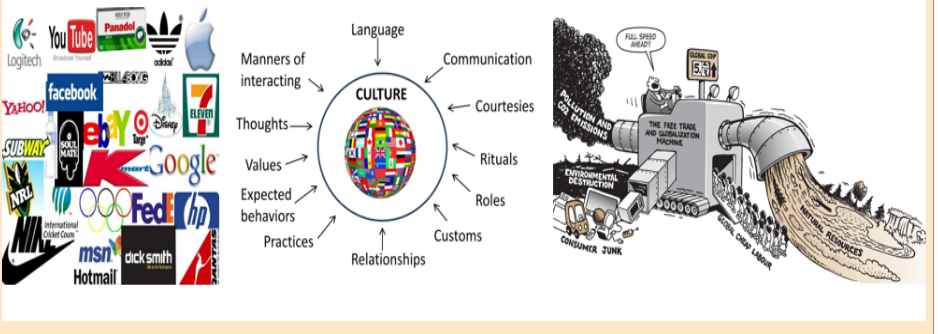
By the end of this unit, I will be able to:

- Explain the causes of globalisation.
- Explain the impact of MNCs and FDIs on economic development.
- Describe the origin of Breton woods conference and the operation of IMF and WB.
- Identify SAPs conditionality to Rwanda from IMF and WB.
- Analyse the impact of globalisation on the economy (local, national and international).
- Extract key principles of globalisation by looking at specific examples of MNCs and FDIs.
- Practice SAPs conditionality from IMF and WB to attain economic growth.
- Appreciate the implication of globalisation on the economy of Rwanda.

Activity 1

Analyse the images and extract below, and undertake research on globalisation to answer the questions that follow.

Figure 1: Globalisation images.



Since ancient times, humans have sought distant places to settle, produce, and exchange goods enabled by improvements in technology and transportation. But not until the 19th century did global integration take off. Following centuries of European colonization and trade activity, that first "wave" of globalization was propelled by steamships, railroads, the telegraph, and other breakthroughs, and also by increasing economic cooperation among countries. The globalization trend eventually waned and crashed in the catastrophe of World War I, followed by postwar protectionism, the Great Depression, and World War II. After World War II in the mid-1940s, the United States led efforts to revive international trade and investment under negotiated ground rules, starting a second wave of globalization, which remains ongoing, though buffeted by periodic downturns and mounting political scrutiny.
https://bit.ly/31tLBC7

Required:

a) Explain what you understand by the term globalization.

b) What are the indicators of globalization?

c) Identify and explain the forms of globalisation portrayed in images above.

d) Describe other different forms in which globalisation can be realised, apart from those forms identified above,

e) From the extract, identify and describe what has sparked off globalisation in the modern world?

f) What do think is the cause of the current increased desire for global interdependence?

Facts

7.1 Meaning of Globalisation

Globalisation refers to the growing interdependence of the world's economies, cultures, and populations, brought about by cross-border trade in goods and services, technology, and flows of investment, people, and information. Economically, globalization involves goods, services, the economic resources of capital, technology, and data. With the increased global interactions comes the growth of international trade, ideas, and culture. Globalization is primarily an economic process of interaction and integration that's associated with social and cultural aspects. Current globalization trends can be largely accounted for by developed economies integrating with less developed economies by means of foreign direct investment, the reduction of trade barriers as well as other economic reforms and, in many cases, immigration.

7.1.1 The main features/ characteristics of globalisation

Globalisation is characterized by;

Liberalisation where there is freedom of the industrialists/businessmen to establish industries, trade or commerce either in their countries or abroad; free exchange of capital, goods, service and technologies between countries;

Free trade between countries where there is absence of excessive governmental control over trade;

Control of economic activities by domestic market and international market; coordination of national economy and world economy;

Connectivity where localities are being connected with the world by breaking national boundaries; forging of links between one society and another, and between one country and another through international transmission of knowledge, literature, technology, culture and information.

Integration of nation-states across the world by common economic, commercial, political, cultural and technological ties; creation of a new world order with no national boundaries;

Being a multi-dimensional process in that there is integration of national economies with the world economy, limited political powers and functions of states, exchange of cultural values between societies and between nations; and the spread of liberalism and capitalism.

Being a top-down process, originating from developed countries and the MNCs (Multinational Corporations) based in them to developing countries that have to accept these things, adapt themselves to them and to be influenced by them.

Interdependence where no country can be said to be totally independent, not needing anything from any other country.

Having a broader & open 'mindset' that is ready to compress the whole universe into its scheme of things; and being ready to receive all ideas that take the whole globe as an area of operation.

Being an Opportunity that opens our markets for entry of multinationals, and also opens all other markets in the whole world for our products & services too.

Caring & sharing whereby the common problems being faced by the people at any part of the world attract immediate attention all over, like global warming, terrorism, or malnutrition, natural disasters etc.

Inevitability & irreversibility of global changes whereby, once attained, its signs & features cannot be stopped.

Linkage between politics and economics where, with the new era of globalization, it is the economics, employment generation and public welfare that determine the need & strength of relations between nations.

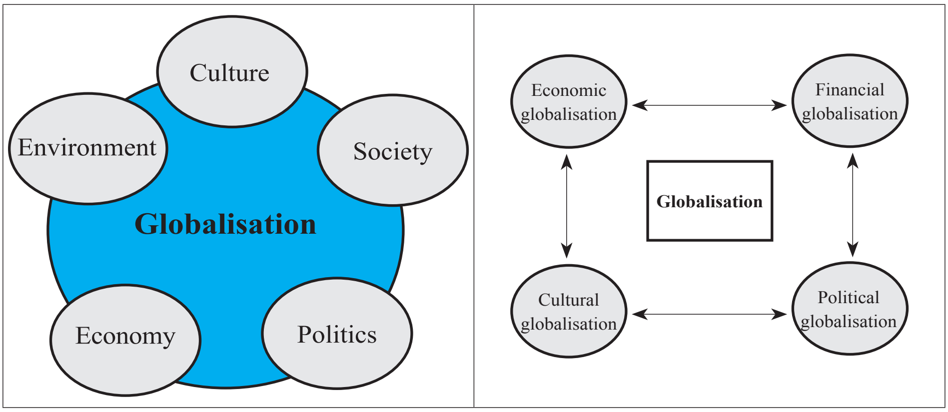
Raised aspirations among billions of people to upgrade their lifestyles where consumers have more choice to pick quality items at right price, and with no boundary restrictions on flow of goods & services.

Excellence: Companies, products and people from any remote part of the world to win over markets and contracts have to showcase their excellence. This means there is pressure on everyone to continuously improve to meet the raised bar of expectations.

Togetherness: Globalisation means that "we are not alone in this Universe and the world is cohabited by others too at far off places." This means that the world is a small global village of linked families.

7.1.2 Types of globalisation

Figure 2: Types of globalisation



(a) *(b)*

1. Economic globalisation

This is a worldwide economic system that permits easy movement of goods, production, capital, and resources (free trade facilitates this) No national economy is an island now. To varying degrees, national economies influence one another. One country which is capital-rich invests in another country which is poor. One who has better technologies sells these to others who lack such technologies. Example is multinational corporations.

The products of an advanced country enter the markets of those countries that have demands for these products. Similarly, the natural resources of developing countries are sold to developed countries that need them. Thus, globalisation is predominantly an economic process involving the transfer of economic resources form one country to another.

2. Technological globalisation

This is the connection between nations through technology such as television, radio, telephones, internet, etc. This was traditionally available only to the rich but is now far more available to the poor. Much less infrastructure is needed now.

3. Political Globalisation. Political globalization refers to the growth of the worldwide political system, both in size and complexity. It includes national governments, their governmental and intergovernmental organizations as well as government-independent elements of global civil society such as international non-governmental organizations and social movement organizations. It is the expansion of a global political system, and its institutions, in which inter-regional transactions e.g. trade are managed. Political cooperation between different countries is a form of globalization that is used to prevent and manage conflict. For example, global organizations such as the United Nations and the World Trade Organization were created to diffuse political issues and maintain order on an international scale.

4. Cultural Globalisation. This refers to the transmission of ideas, meanings, and values around the world in such a way as to extend and intensify social relations. It involves the merging or "watering down" of the world's cultures e.g. food, entertainment, language, etc. This process is marked by the common consumption of cultures that have been diffused by the Internet, popular culture media, and international travel. Cultural globalisation has been facilitated by the information revolution, the spread of satellite communication, telecommunication networks, information technology and the Internet etc. This global flow of ideas, knowledge and values is likely to flatten out cultural differences between nations, regions and individuals.

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

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

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

8. Environmental globalisation: This refers to the internationally coordinated practices and regulations (often in the form of international treaties) regarding environmental protection. An example of environmental globalization would be the International Tropical Timber Organization and promoting sustainable management of tropical forests. Environmental globalization is usually supported by non-governmental organizations and governments of developed countries, but opposed by governments of developing countries which see pro-environmental initiatives as hindering their economic development. Environmental globalization is related to economic globalization, as economic development on a global scale has environmental impacts on such scale, which is of concern to numerous organizations and individuals.

9. Military globalisation: This is the process which embodies the growing extensity and intensity of military relations among the political units of the world system. It reflects both the expanding network of worldwide military ties and relations, as well as the impact of key military technological innovations (from steamships to satellites), which over time, have reconstituted the world into a single geostrategic space. Military globalization implies firmer integration of armed forces around the world into the global military system.

Facts

Globalisation is not a new phenomenon. The world economy has become increasingly interdependent for a long time. However, in recent decades the process of globalisation has accelerated; this is due to a variety of factors, among which include the following:

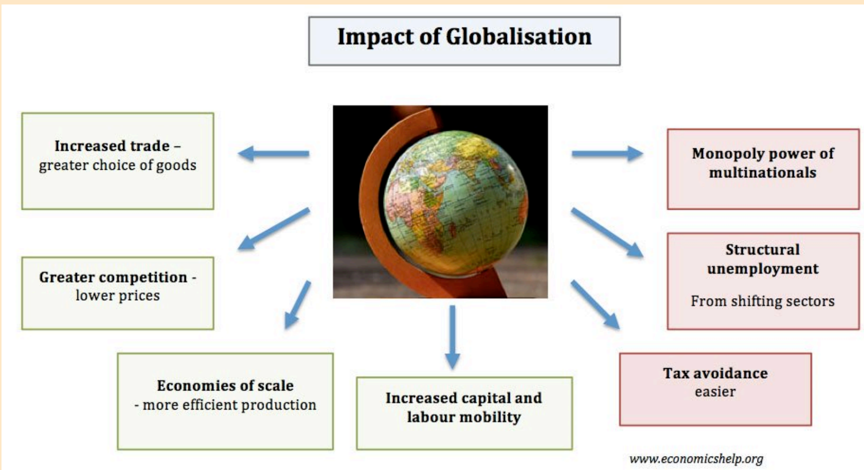
1. Improved transport, making global travel easier. For example, there has been a rapid growth in air-travel, enabling greater movement of people and goods across the globe.
2. Containerisation. From 1970, there was a rapid adoption of the steel transport container. This reduced the costs of inter-modal transport making trade cheaper and more efficient.
3. Improved technology which makes it easier to communicate and share information around the world. E.g. internet. Therefore, people from any country can bid for the right to provide a service.
4. Growth of multinational companies with a global presence in many different economies.
5. Growth of global trading blocs which have reduced national barriers. (e.g. European Union, NAFTA, ASEAN).
6. Reduced tariff barriers encourages global trade. Often this has occurred through the support of the WTO.
7. Firms exploiting gains from economies of scale to gain increased specialisation. This is an important feature of new trade theory.
8. Growth of global media. Such as internet, telecommunication etc.
9. Global trade cycle. Economic growth is global in nature. This means countries are increasingly interconnected. (E.g. recession in one country affects global trade and invariably causes an economic downturn in major trading partners.)
10. Improved mobility of capital. In past few decades, there has been a general reduction in capital barriers, making it easier for capital to flow between different economies. This has increased the ability for firms to receive finance. It has also increased the global interconnectedness of global financial markets.

11. Increased mobility of labour. People are more willing to move between different countries in search for work. Global trade remittances now play a large role in transfers from developed countries to developing countries

7.1.3 Causes of globalisation

Activity 2

Figure 3: effects of globalisation



Based on figure 3 above, use the research knowledge gained in activity 1 about globalisation to assess the impact of globalisation on world economies.

7.1.4 Effects of globalisation

The aim of globalization is to benefit individual economies around the world by making markets more efficient, increasing competition, limiting military conflicts, and spreading wealth more equally. The wide-ranging effects of globalization are complex and politically charged. As with major technological advances, globalization benefits society as a whole, while harming certain groups. Understanding the relative costs and benefits can pave the way for alleviating problems while sustaining the wider payoffs. Therefore, the effects of globalisation to global countries may include among others the following.

Facts

Financial and industrial globalisation is increasing substantially and is creating new opportunities for both industrialised and developing countries. The largest impact has been on developing countries, which are now able to attract foreign investors and foreign capital.

Positive effects of globalisation

Globalisation can create new opportunities, new ideas, and open new markets that an entrepreneur may have not had in their home country. As a result, there are a number of positives associated with globalisation:

- Inward investment by Trans-National corporations (TNCs) has helped countries by providing new jobs and skills for local people.
- Foreign direct investment (FDI) have increased at a much greater rate than the growth in world trade, helping boost technology transfer, industrial restructuring, and the growth of global companies. They, therefore, have brought wealth and foreign currency to local economies as they buy local resources, products and services. The extra money created by this investment has been spent on education, health and infrastructure for development purposes.
- It has enabled the sharing of ideas, experiences and lifestyles of people and cultures. People have experienced foods and other products not previously available in their countries.
- Increased competition from globalization has helped stimulate new technology development, particularly with the growth in FDI, which has helped improve economic output by making processes more efficient.
- Globalisation has increased awareness of events in far-away parts of the world. This has helped to make people more aware of global issues such as deforestation and global warming and alerted them to the need for sustainable development
- Globalization has tended to bring people into contact with foreign people and cultures. This has reduced the issue of xenophobia and its negative effects.
- Open world trade has increased economic growth and raised living standards of people in different countries across the world.

- Globalization has enabled large companies to realize economies of scale that reduce costs and prices, which in turn has supported further economic growth, although this has hurt many small businesses attempting to compete domestically.
- Economic globalization has given governments of developing nation's access to foreign lending. When these funds are used on infrastructure including roads, health care, education, and social services, the standard of living in the country increases. If the money is used only selectively, however, not all citizens will participate in the benefits.
- Globalization has led to freer trade between countries. This is one of its largest benefits to developing nations. Homegrown industries see trade barriers fall and have access to a much wider international market. The growth this has generated, has allowed companies to develop new technologies and produce new products and services.
- It has allowed businesses in less industrialized countries to become part of international production networks and supply chains that are the main conduits of trade.
- Globalisation has led to more access to capital flows, technology, human capital, cheaper imports and larger export markets.
- Access to new markets; It has created greater opportunities for firms in less industrialized countries to tap into more and larger markets around the world.
- Reduced tariff barriers encouraging global trade. Often this has occurred through the support of the WTO.
- Globalisation has helped build a global economic order governed by mutually accepted rules and overseen by multilateral institutions. This has created a better world with countries seeking to cooperate with one another to promote prosperity and peace. Free trade and the rule of law being the mainstays of the system, have helped to prevent most economic disputes from escalating into larger conflicts.

E.g.International Monetary Fund (IMF), World Bank (WB), United Nations (UN), North Atlantic Treaty Organisation (NATO), World Trade Organisation (WTO) etc.

- Globalization has encouraged each country to specialize in what it produces best using the least amount of resources, known as comparative advantage. This has made production more efficient, promoted economic growth, and lowered prices of goods and services, making them more affordable especially for lower-income households.
- Larger markets have enabled companies to reach more customers and get a higher return on the fixed costs of doing business, like building factories or conducting research. Technology firms have taken special advantage of their innovations this way.
- Competition from abroad has driven different firms in different countries to improve their products. Consumers have had better products and more choices as a result.
- Expanded trade has spurred the spread of technology, innovation, and the communication of ideas. The best ideas from market leaders has spread more easily globally.
- Better-paying positions have opened up in manufactured exports, especially in high-tech areas, such as computers, chemicals, and transportation equipment and other high-skill work, notably in business services, such as finance and real estate.
- Globalization has helped narrow inequality between the poorest and richest people in the world. By outsourcing their services to developing countries, Transnational companies have saved money and changed people's lives. Because of this, poverty rates have declined worldwide over the past decades.
- One of the primary advantages of globalization is the free trade of goods and resources. For instance, a country that specializes in motor vehicles will produce cars and accessories in a location that achieves the lowest costs possible, and sell them on both local and foreign markets. This means that people living in other countries will be able to purchase these vehicles for less. At the same time, they will have access to a wider range of brands and models.
- Globalization has allowed people to relocate to wealthier countries and start their own business or find work. This has led to higher incomes and more opportunities in life. Additionally, migrants have always sent money home without paying exorbitant fees.

- The free movement of information and technology has enabled trade unions to fight for workers' rights worldwide. As new policies and regulations were enforced, labor rights increased. Additionally, sensitive issues, such as equal pay and gender equity, are becoming less and less prevalent.
- Multinational corporations are constantly expanding and hiring people in the countries where they operate. Others implement exchange programs to offer their employees the chance to work abroad. This has further accelerated globalization and promoted economic growth in different countries around the globe.

Negative effects of globalisation

Globalisation has had a profoundly positive impact on people's lives over the past half-century. Nevertheless, despite its substantial benefits, it has been blamed for many shortcomings in the modern economy and society as seen below.

1. The free trade of goods, services and information set the world economy into a cycle of income and employment growth. However, This, has led to declining money flows and tight credit across local and national economies.
2. Furthermore, employees in developed countries are losing their jobs due to pay cuts. More and more companies are choosing to outsource work and export jobs as a means to keep the costs low, and this has led to unemployment in most countries.
3. Large enterprises are now able to exploit tax havens worldwide, which has affected the local economy.
4. The growth of international trade is worsening income inequalities, both between and within industrialized and less industrialized nations.
5. The practice of outsourcing for cheaper labor is exploitative and widens the gap between the world's rich and the world's poor.
6. Globalization has led to the interdependence between nations, which has caused regional or global instabilities where local economic fluctuations have ended up impacting a large number of countries relying on them.

7. Political globalization has led to declining importance of the nation-state and the rise of other actors on the political scene.
8. Globalization has often been criticized for taking away jobs from domestic companies and workers. Domestic industries go out of business because imports from other countries drive down prices, even if consumption increases. Small companies have found it difficult to compete and thus shut down, leaving workers unemployed, while the larger industries have experienced a significant protracted decline.
9. In addition, it has contributed to job displacement especially low-wage workers in certain regions. Many of them other than facing lower earnings have been dropped out of the workforce. This is due to use of labor-saving technologies, like automated machines and artificial intelligence.
10. Globalization has led to the increase in wages for workers, which has hurt corporate profitability. For example, rich countries which have a high comparative advantage in developing software, have driven up the price of software engineers around the world, thus making it difficult for foreign companies to compete in the market.
11. The benefits of globalization have been unfairly sloped towards rich nations or individuals, creating greater inequalities and leading to potential conflicts both nationally and internationally as a result.
12. Globalisation has increased Capital flight especially in developing nations where assets or money rapidly flow out because of increase in unfavorable financial conditions such as taxes, tariffs, labor costs, government debt and capital controls as a result of sharp drop in the exchange rate.
13. Globalisation has moved taxation away from corporations, and onto individual citizens. Corporations have the ability to move to locations where the tax rate is lowest. Individual citizens have much less ability to make such a change. Also, with today's lack of jobs, each community competes with other communities with respect to how many tax breaks it can give to prospective employers.
14. Globalisation has set up a currency "race to the bottom," with each country trying to get an export advantage by dropping the value of its

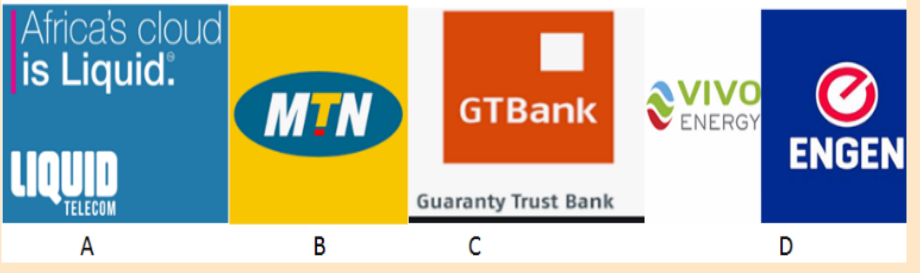
currency. Because of the competitive nature of the world economy, each country needs to sell its goods and services at as low a price as possible. This has been done in various ways like paying its workers lower wages; allowing more pollution; using cheaper more polluting fuels; or debase the currency by printing money in the hope that this will produce inflation and lower the value of the currency relative to other currencies.

15. Globalisation has encouraged dependence on other countries for essential goods and services. With globalization, goods can often be obtained cheaply from elsewhere. Countries have come to believe that there is no point in producing their own food and clothes which they can obtain cheaply from other countries. It has become easy to depend on imports and specialize in something else and become dependent on other countries for essential commodities.
16. Globalisation ties countries together, so that if one country collapses, the collapse is likely to ripple through the system, pulling many other countries with it. This is because countries are increasingly interdependent.
17. Cultural uniqueness has been lost in favor of homogenization and a "universal culture" that draws heavily from the western culture. As a result of globalisation, the values and norms of developed countries are gradually rooted in developing countries. This has led to the growth of a monoculture - the culture of the north (developed countries) being imposed on the South (developing countries). This has led to erosion of the cultures and loss of identity of developing countries.
18. Global commerce is increasingly dominated by transnational corporations which seek to maximize profits without regard for the development needs of individual countries or the local populations
19. Competition among developing countries to attract foreign investment has led to a "race to the bottom" in which countries dangerously lower environmental standards.

7.2 Multinational Corporation (MNC)

Activity 3

Figure 3: MNC aspects



With the help of the images in figure 3 above, undertake research about multinational corporations and answer the questions that follow.

(i) What activity does each image above portray?

(ii) Where does each activity in the images above originate from?

(iii) Identify different other companies that are not of Rwandan origin but operate in Rwanda and deal in other activities other than those cited above.

(iv) How have such companies' activities impacted the development trend of our country?

Facts

A multinational corporation or worldwide enterprise is an enterprise operating in several countries but managed from one (home) country. It is an organisation that owns or controls production of goods or services in one or more countries other than their home country. It can also be referred to as an international corporation, a "transnational corporation", or a stateless corporation.

Generally, any company or group that derives a quarter of its revenue from operations outside of its home country is considered a multinational corporation.

There are four categories of multinational corporations:

1. A multinational, decentralised corporation with strong home country presence.
2. A global, centralised corporation that acquires cost advantage through centralised production wherever cheaper resources are available.
3. An international company that builds on the parent corporation's technology.
4. A transnational enterprise that combines the previous three approaches.

A multinational corporation is usually a large corporation which produces or sells goods or services in various countries. MNCs can get involved in;

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

Multinational corporations in Rwanda

Table 1: Some multinational corporations (MNCs) with affiliates in Rwanda are listed below.

Company	Home Country	Sector
Arab Contractors (Rwanda) Ltd	Egypt	Construction
Brasseries Et Limonaderies Du Rwanda SA	Switzerland	Food, beverages, and tobacco
Maersk Rwanda Limited	Denmark	Public administration
Rwandex Sa	Switzerland	Food, beverages, and tobacco

Other example of Multinational corporations in Rwanda

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

Positive effects

1. MNCs bridge the forex gap in LDCs by increasing forex inflow.
2. They increase employment opportunities for citizens of the host countries since they operate on large scales.
3. They close the investment gap through forex investment abroad.
4. They lead to improvement in domestic technology through transfer of superior technology to LDCs based on research and development.
5. MNCs produce more output especially processed or manufactured which increase exportation of manufactured goods hence more forex to LDCs.
6. MNCs promote capital accumulation in LDCs through transfer of capital and building infrastructure.
7. MNCs produce better quality products which help to improve standards of living of people in the society.
8. They bring new marketing techniques in LDCs markets research and promotional methods which encourage competition and efficiency.
9. They give revenue to the government through taxes imposed on activities of the MNCs.
10. They help to train labour in the management of basic skills and entrepreneur ability in LDCs.
11. MNCs make a lot of profits which are ploughed back leading to the expansion of the economy there by promoting economic growth.

12. They undertake high risks and can invest in long term projects like mining plantation and agricultural industries that bring about rapid economic growth and development.
13. They are financially strong and hence provide large and cheap capital to LDCs by way of direct investment.
14. They increase infrastructural development through construction of telecommunication etc.
15. MNCs increase the exploitation of domestic resources which increase volume of productivity hence increasing export exchange.
16. They promote international cooperation through consortiums hence increasing the volume of trade.
17. They encourage competition which leads to efficiency and better quality products.
18. They help in filling the skilled manpower gap through exportation of expatriates or trained personnel to the recipient countries.

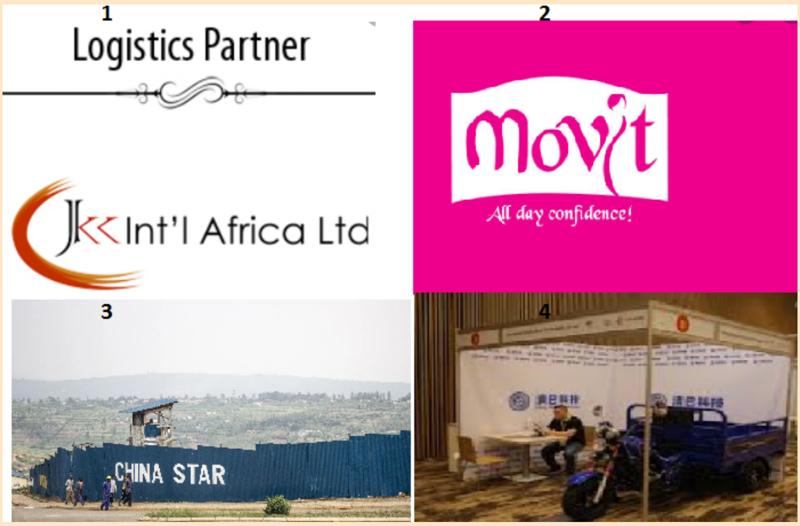
Negative effects of MNCs

1. MNCs repatriate their profits to their mother countries which lead to resources outflow from LDCs thus disabling the development potentials of LDCs.
2. They are given tax exemption and holidays which reduce net government revenue from them.
3. MNCs usually use capital intensive technology and therefore may not help to reduce their problems of unemployment in LDCs which are labour surplus economies.
4. They create social costs like quick exhaustion of natural resources, environmental degradation etc. since they operate on large scale.
5. MNCs influence internal policies of LDCs by bribing the legislature for example offering employment to the relatives of politicians in their companies and at times they subvert domestic fiscal policies which result into low standards of living.
6. MDCs accelerate regional or sector imbalances eg urban and rural areas since they mostly set up their production activities in urban areas where infrastructure is already developed.
7. MDCs cause income inequalities because they reserve top jobs for their nationals who are highly paid and low paying jobs to the national of investment countries.

8. They promote external dependency of host countries on the countries where they originate.
9. They reduce domestic initiative in technological and manpower development.
10. MNCs can bring about discontent and unrest among workers employed by the government and indigenous firms due to the wage differentials between the workers in MNCs and other workers.

Activity 4

Figure 4: Foreign Direct Investments in Rwanda



With the aid of the images above, undertake research and answer the questions that follow;

(i) Identify the type of activities they deal in.
(ii) State their countries of origin.
(iii) What economic term is given to such companies?
(iv) Cite different other examples of companies that are not of Rwandan origin that extend their services to Rwanda.
(v) Analyse the contribution of such companies to the development process of Rwanda.

Facts

7.3 Meaning of Foreign Direct Investments

Foreign direct investments are the net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor. It refers to direct investment equity flows in the reporting economy. It is the sum of equity capital, reinvestment of earnings, and other capital. Direct investment is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy. Direct foreign investment involves the transfer of productive resources or capital by foreign individuals, companies and MNCs to operate in an economy other than that of the investor. Ownership of 10 percent or more of the ordinary shares of voting stock is the criterion for determining the existence of a direct investment relationship.

Although FDI stocks have increased in recent years due to Rwanda's political stability and measures focused on improving the business climate, FDI flows still remain rather weak. According to UNCTAD 2020 World Investment Report, inflows increased from USD 382 million in 2018 to USD 420 million in 2019. FDI stock was estimated at USD 2,6 billion at the end of 2019. Investments are mainly targeting the sectors of mining, construction and real estate, infrastructure and information and communication technologies. According to statistics from Rwanda Development Board (RDB), the main investing countries are Portugal, the UK, India and the UAE.

In 2019, Rwanda recorded a record total investment level of 2.46 billion USD, 37% of which in foreign direct investment (RDB). Among the factors explaining this growth in investment are support mechanisms such as the One Stop Center, follow-up services and exchange platforms between senior management and business leaders. The Bugesera International Airport construction project alone absorbed USD 400 million.

The government of Rwanda is seeking to attract more FDI and in 2015 approved a new Investment Code aimed at providing tax breaks and other incentives to investors. In addition, the country has no statutory limit to foreign ownership or control, nor any official economic or industrial strategy that discriminates against foreign investors. On the other hand, the low human resource capacity of Rwanda, the poor infrastructure, its landlockedness and its high operating costs are some of the factors that limit the potential attractiveness of the country. Also, the political instability of its neighboring country the Democratic Republic of Congo, has had an impact on the entire Great Lakes region and has discouraged international companies from investing in this region.

However, Rwanda has many advantages: a large methane reserve, an expanding mining potential which remains to be explored and the reputation of being one of the least corrupt countries in Africa. Finally, the Government has continued to develop liberal policies to make Rwanda a hub of trade and services. This strategy has been very successful since the country has been considered one of the most reformist states of the past 15 years. The country is also impressively ranked in the Doing Business 2020 report published by the World Bank, ranking 38th out of 190 economies in terms of ease of doing business.

Examples of FDIs in Rwanda

Some of the registered foreign direct investments in Rwanda include; *JKK International from Dubai which started a construction company; China Electronics, Lifan moto taxi-Chinese, ALINK Technologies, and Yvonne Exclusive Design an upmarket fashion store, Egyptian House of Kitchenware which opened a shop in Kimironko – Gasabo district for general trading, and Tanzania's Dodoma that makes mattresses.*

Sorwathe Tea Ltd., Forestry and Agricultural Investment Management, and West rock Coffee Holdings, LLC, Kenya Commercial Bank (KCB), Kenya's National Media Group (NMG).

China, Indonesia and Germany are the main investing countries (Source: Doing Business - 2016.)

In early 2016, the Rwandan Development Board (RDB) signed an agreement with Thomson Reuters to support further innovation within the country.

7.3.1 Advantages of foreign direct investments

The following are the advantages of foreign direct investments.

1. They increase the stock of capital in LDCs thus help break the cycle of poverty which enables LDCs to achieve rapid economic growth.
2. FDIs provide managerial, administrative and technical personnel, new technology, research and innovation in LDCs. This helps to improve LDCs technics of production hence more employment opportunities.
3. They increase government revenue from taxes imposed on production activities undertaken by foreign investments.
4. FDIs increase productivity and efficiency due to high levels of technology used which leads to more export earnings and improvement in the Balance of payment position.
5. They encourage entrepreneurial development in the country due to competition thus would lead to the citizens of that country to invest in their country hence more foreign exchange earnings.
6. They create employment opportunities in the recipient countries.
7. They increase savings thus closing the savings investment gap in LDCs.
8. Due to the inflow of capital assets, foreign investment promotes capital accumulation in LDCs.
9. Foreign investments help in the exploitation of idle resources in LDCs thus promoting economic growth and development.
10. They increase consumer choice due to production of wide variety of quality products due massive productions.
11. FDIs increase the exploitation of domestic infrastructure e.g. transport facilities, communication facilities etc.
12. They accelerate industrial growth through manufacturing and provision of services.
13. They promote international cooperation hence increase the volume of imports and exports.
14. Local firms become efficient through competition.
15. They fill the manpower gap through importation of expatriates' manpower.

7.3.2 Disadvantages of foreign direct investments

Below are the disadvantages of foreign direct investments

1. Its leads to profit repatriation and capital outflow thus worsening the balance of payment deficits in LDCs.
2. FDIs increase government expenditure in form of provision of basic facilities like land, power and other basic facilities as well as tax concessions, tax holidays, subsidised inputs etc.
3. They cause income inequality in the recipient countries because top posts are reserved for their nationals and pay them very highly while citizens of the recipients' country occupy low status and low paying posts.
4. Foreign investors at times exert pressure on the government and may influence the decision made by the government of the recipient country which brings about dependency and loss of autonomy in the recipient country.
5. They bring about instabilities in the recipient country due to re-allocation of their investments into other countries.
6. Foreign countries use capital intensive technology which creates technological unemployment thus may not help in solving the problem of unemployment.
7. They increase demonstration effect in the recipient country due to increased number of foreigners who impose life style of developed countries in LDCs thus start copying the consumption habits and lifestyle of the foreigners.
8. Most of the private foreign investments are urban based and this creates the problems of rural urban migration and its negative effects.
9. It leads to loss of government revenue through tax holidays, concessions etc.
10. FDLs causes dumping through importation for outsider or low quality equipment.
11. FDIs may lead to loss of markets of products from indigenous enterprises.
12. FDIs may lead to irrational and exploitation of domestic resources.

7.3.3 Measures of attracting foreign investors in Rwanda

Activity 5

Visit the library or the internet or any other economics source and undertake research on FDIs in Rwanda and express yourself on the following.

a) What Policy measures has the government of Rwanda taken to attract more foreign investors in the country?

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

Measures of attracting foreign investors in Rwanda

The Government of Rwanda (GoR) understands that private sector development is critical if Rwanda is to achieve its aim to reach middle-income status and to reduce the country's reliance on foreign aid. Over the past decade, the Government of Rwanda has undertaken a series of pro-investment policy reforms intended to improve the investment climate, expand trade in products and services, and increase levels of foreign direct investment. These include;

Establishment of strong and powerful investment promotion agency.

In 2006, the Government of Rwanda consolidated multiple investment-related government agencies, including the Office of Tourism and National Parks, and the Rwanda Investment and Export Promotion Agency, to establish the Rwanda Development Board (RDB), which serves today as the country's chief investment promotion agency.

Easy and cheap means of obtaining foreign exchange.

There is no difficulty obtaining foreign exchange in Rwanda or transferring funds associated with an investment into a usable currency and at a legal market-clearing rate. In 1995, the government abandoned the dollar peg and established a floating exchange rate regime, under which all lending and deposit interest rates were liberalized. The central bank holds daily foreign exchange sales freely accessed by commercial banks.

Existence of strong and powerful measures against corruption

The government has maintained a high-profile anti-corruption effort and senior leaders articulate a consistent message emphasizing that fighting corruption is a key national goal. The government investigates corruption allegations and generally prosecutes and punishes those found guilty

Existence of favorable migration policies for foreigner investors.

Rwandan law provides permanent residence and access to land to investors who deposit USD 500,000 in a commercial bank in the country for a minimum of six months. There are neither statutory limits on foreign ownership or control, nor any official economic or industrial strategy that discriminates against foreign investors.

Ensuring stable and secure investment climate.

Rwanda is a stable country with low violent crime rates. A strong police and military provide a security umbrella that minimizes potential criminal activity and political disturbances. This has given Rwanda as a country to be among the top countries in African with best and secure investment climate.

Formation of economic integration

Rwanda is a member of the East African Community (EAC), and participates in a customs union that helps facilitate the movement of goods produced in the region and allows EAC citizens with certain skills to work in any member state.

Established of investment facilitates.

Rwanda has also established a free trade zone outside the capital, Kigali, which includes current and planned future communications infrastructure. Bonded warehouse facilities are now available both in and outside of Kigali for use by businesses importing duty free materials.

Existence of cheap and fast business registration.

The government through RDB offers one of the fastest business registration processes in Africa: new investors can register online at RDB's website and receive approval to operate in less than 24 hours, and the agency's "one-stop shop" helps foreign investors secure required approvals, certificates, and work permits.

The Government of Rwanda established the Privatization Secretariat and the Rwanda Public Procurement Agency to ensure transparency in government tenders and divestment of state-owned enterprises. Rwanda's ranking in Transparency International's "Corruption Perception Index" has improved significantly, falling from 102 in 2008, to 49 in 2013, the top ranked country in eastern Africa.

The government reserves the right to expropriate property "in the public interest" and "for qualified private investment" under the expropriation law of 2007. The government and landowner negotiate compensation directly depending on the importance of the investment and the size of the expropriated property. RDB may facilitate expropriation in cases where the expropriation is potentially controversial

Measures to settle foreign investments disputes.

Rwanda is a signatory to the Convention on the Settlement of Investment Disputes (ICSID) and African Trade Insurance Agency (ATI). ICSID seeks to remove obstructions to private investment posed by non-commercial risks, while ATI covers risk against restrictions on import and export activities, inconvertibility, expropriation, war, and civil disturbances. Rwanda is a member of the East African Court of Justice for the settlement of disputes arising from or pertaining to the East African Community (EAC). Rwanda has also acceded to the 1958 New York Arbitration Convention.

Provision of tax incentive to the foreign investors.

Registered Investors who demonstrate capacity to add value and invest in priority sectors have generally enjoyed more tax and investment incentives, including Value Added Tax (VAT) exemptions on all imported raw materials, 100 percent write-off on research and development costs, five-to-seven percent reduction in corporate income tax for firms whose exports are worth at least USD 3 million, duty exemption on equipment, and a favorable accelerated rate of depreciation of 50 percent in the first year. The government also offers grants and special access to credit to investors who develop in rural areas.

Publicity of a country's investment opportunities abroad.

RDB has been successful in developing investment incentives and publicizing investment opportunities abroad. Rwanda air has a number of weekly flights in different parts of the world. Visit Rwanda was also established as a nation's tourism board as a way of advertising and developing a country's tourism industry. All such efforts attract many foreign investments in the country.

Protection of Property Rights.

Rwanda has laws that protects and facilitates acquisition and disposition of all property rights. Investors involved in commercial agriculture have leasehold titles and are able to secure property titles, if necessary. A property registration and land titling effort, the result of a 2005 land law, was completed in 2013.

Fair competition between domestic and foreign investors.

Rwandan law allows private enterprises to compete with public enterprises under the same terms and conditions with respect to access to markets, credit, and other business operations. Since 2006, the government has made an effort to privatize State-Owned Enterprises (SOEs), to reduce the government's non-controlling shares in private enterprises, and attract FDI, especially in the information and communications, tourism, banking, and agriculture sectors.

Existences of clear rules and investment procedures.

The Government of Rwanda has implemented transparency of the regulatory system; the government generally employs transparent policies and effective laws to foster clear rules consistent with international norms. Institutions such as the Rwanda Revenue Authority, the Ombudsman's office, Rwanda Bureau of Standards (RBS), the National Public Prosecutions Authority (NPPA), the Rwanda Utilities Regulatory Agency, the Public Procurement Agency, and the Privatization Secretariat all have and provide clear rules and investment procedures.

There is a growing awareness of corporate social responsibility (CSR), but only a few companies – chiefly foreign-owned – have implemented sustainable programs. In recognition of the firm's strong commitment to CSR, the U.S. Department of State awarded Sorwathe, a U.S.-owned tea producer in Kinihira, Rwanda, the Secretary of State's 2012 Award for Corporate Excellence for Small and Medium Enterprises.

Trade agreements between Rwanda and other countries.

Rwanda is eligible for trade preferences under the African Growth and Opportunity Act (AGOA), which the United States enacted to extend duty-free and quota-free access to the U.S. market for nearly all textile and handicraft goods produced in eligible beneficiary countries. The U.S. and

Rwanda signed a Trade and Investment Framework Agreement (TIFA) in 2006, and a Bilateral Investment Treaty (BIT) in 2008. Rwanda has also signed bilateral investment treaties with Germany (1967) and Belgium (1985).

The Export-Import Bank (EXIM) continues its program to ensure short-term export credit transactions involving various payment terms, including open accounts that cover the exports of consumer goods, services, commodities, and certain capital goods. Rwanda is a member of the Multilateral Investment Guarantee Agency (MIGA) which issues guarantees against non-commercial risks to enterprises that invest in member countries and the African Trade Insurance Agency (ATI).

Observation of labour rights in Rwanda

Rwanda attempts to adhere to International Labor Organization (ILO) conventions protecting worker rights. Policies to protect workers in special labor conditions exist, but enforcement remains inconsistent. The government encourages, but does not require, on-the-job training and technology transfer to local employees

7.3.4 Hurdles and constraints of FDIs in Rwanda

The following are the hurdles and constraints of FDI's in Rwanda:

- Rwanda suffers from a shortage of skilled labour, including accountants, lawyers, and technicians.
- Some firms have reported occurrences of petty corruption in the customs clearing process, but there are few or no reports of corruption in transfers, dispute settlement, regulatory system, taxation, or investment performance requirements.
- Political instabilities and insecurities with in and in the neighbouring countries, e.g. fighting in the eastern Democratic Republic of Congo (DRC) between Congolese armed forces (FARDC) and the M23 has scared most investors, especially in the areas of Gisenyi and Rubavu. Grenade attacks aimed at the local population have occurred on a recurring basis over the last five years in Rwanda. Four attacks occurred in Kigali in 2013 and early 2014, killing five and injuring 48 persons all which reduce confidence of investors in the security of the country.

- Some investors claim that the RRA unfairly targets foreign investors for audits. In recent years, several investors raised concerns that RRA breached Rwandan law by auditing corporate financial statements that had already exceeded the statute of limitations for review.
- Some investors complain that the strict enforcement of tax, labour, and environmental laws impede investment. In 2009, the government updated the labour code to simplify labour recruitment and facilitate the hiring, firing, and retention of competent staff.
- Some investors have complained that the application process for work permits and extended stay visas has become onerous (burdensome). Immigration authorities frequently request extra documentation detailing applicants' qualifications and, at times, have taken several months to adjudicate cases.
- Some investors have complained that coordination between RDB and Rwanda Revenue Authority (RRA) is limited, resulting in assessment by RRA on duties or taxes on registered investments despite RDB's assurance that such investments qualified for tax-exempt or tax-incentivised status.
- There are no laws requiring private firms to adopt articles of incorporation or association that limit or prohibit foreign investment, participation, or control.
- A 2012 report by Rwanda's office of the Auditor General cited continuing problems with inappropriate procurement methods, but said violations had reduced significantly from years past.
- Rwanda's judicial system suffers from a lack of resources and capacity, including functioning courts. The Heritage Foundation's Economic Freedom Index has cited the judiciary's lack of independence from the executive. Investors cite the Government of Rwanda's casual approach to contract sanctity and say the government fails to enforce court judgments in a timely fashion.
- Despite RDB's investment facilitation role, some foreign investors say they face difficulty in obtaining or renewing work visas due to the government of Rwanda's demonstrated preference for hiring local or EAC residents over third country nationals.

- Investors have also cited the inconsistent application of tax incentives and import duties as a significant challenge to doing business in Rwanda. Under Rwandan law, foreign firms should receive equal treatment with regard to taxes, and access to licenses, approvals, and procurement.
- Potential and current investors cite a problem of high transport costs, which reduces their profit margin.
- A small domestic market due to prevalent poverty levels in Rwanda, limited access to affordable financing and high interest rates on borrowing that increase costs of production.
- Inadequate infrastructure in form of roads and communication network, power facilities, water etc.
- Ambiguous tax rules which normally scare investors away thus reducing the would be social and economic benefits from.

7.4 Global Financial Systems and Institutions

Activity 6

Undertake a documentary research about Global financial systems and institutions and share your views in class about.

(i) What global financial system and Global financial institutions are.

(i) What is the role of Global financial system?

(i) What are the components of Global financial system?

Facts

7.4.1: Meaning of Global Financial Systems and Institutions

1. Global financial systems.

The global financial system is the worldwide framework of legal agreements, institutions, and both formal and informal economic actors that together facilitate international flows of financial capital for purposes of investment and trade financing. Since emerging in the late 19th century during the first modern wave of economic globalization, its evolution is marked by the establishment of central banks, multilateral treaties, and intergovernmental organizations aimed at improving the transparency, regulation, and effectiveness of international markets.

While the global financial system is edging toward greater stability, governments must deal with differing regional or national needs. Some nations are trying to systematically discontinue unconventional monetary policies installed to cultivate recovery, while others are expanding their scope and scale. Emerging market policymakers face a challenge of precision as they must carefully institute sustainable macroeconomic policies during extraordinary market sensitivity without provoking investors to retreat their capital to stronger markets. Nations' inability to align interests and achieve international consensus on matters such as banking regulation has perpetuated the risk of future global financial catastrophes.

The Global financial system has two main functional components:

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

2. Global institutions (Bretton woods institutions).

The global Institution main components.

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

A Global financial institution is a financial institution that has been established (or chartered) by more than one country, and hence are subjects of international law. Its owners or shareholders are generally national governments, although other international institutions and other organizations occasionally figure as shareholders. The best-known IFIs were established after World War II to assist in the reconstruction of Europe and provide mechanisms for international cooperation in managing the global financial system. They include the World Bank, the IMF, and the International Finance Corporation.

7.4.2 Bretton Woods Conference

The Bretton Woods Conference, formally known as the United Nations Monetary and Financial Conference, was the gathering of 730 delegates from all 44 Allied nations at the Mount Washington Hotel, situated in Bretton Woods, New Hampshire, United States, to regulate the international monetary and financial order after the conclusion of World War II.

The conference was held from July 1–22, 1944. Agreements were signed that, after legislative ratification by member governments, they establish the International Bank for Reconstruction and Development (IBRD) and the International Monetary Fund (IMF).

The Bretton Woods Conference had three main results:

1. Articles of Agreement to create the IMF, whose purpose was to promote stability of exchange rates and financial flows.
2. Articles of Agreement to create the IBRD, whose purpose was to speed reconstruction after the Second World War and to foster economic development, especially through lending to build infrastructure.
3. Other recommendations for international economic cooperation. The Final Act of the conference incorporated these agreements and recommendations. Within the Final Act, the most important part in the eyes of the conference participants and for the later operation of the world economy was the IMF agreement. Its major features were:
   - An adjustably pegged foreign exchange market rate system: Exchange rates were pegged to gold. Governments were only supposed to alter exchange rates to correct a "fundamental disequilibrium."
   - Member countries pledged to make their currencies convertible for trade-related and other current account transactions. There were, however, transitional provisions that allowed for indefinite delay in accepting that obligation, and the IMF agreement explicitly allowed member countries to regulate capital flows. The goal of widespread current account convertibility did not become operative until December 1958, when the currencies of the IMF's Western European members and their colonies became convertible.

- As it was possible that exchange rates thus established might not be favourable to a country's balance of payments position, governments had the power to revise them by up to 10% from the initially agreed level ("par value") without objection by the IMF. The IMF could concur in or object to changes beyond that level. The IMF could not force a member to undo a change, but could deny the member access to the resources of the IMF.
- All member countries were required to subscribe to the IMF's capital. Membership in the IBRD was conditioned on being a member of the IMF. Voting in both institutions was apportioned according to formulas giving greater weight to countries contributing more capital ("quotas").

The conference conducted its major work through three "commissions."

1. Commission I dealt with the IMF
2. Commission II dealt with the IBRD
3. Commission III dealt with "other means of international financial cooperation" It was a venue for ideas that did not fall under the other two commissions.

7.4.3 International monetary fund (IMF)

Activity 7

Visit the library or the Internet or any economics resource, undertake research on IMF and with reference to the knowledge gained in activity 6, discuss amongst yourselves in class about;

(i) What led to the establishment of IMF?
(ii) The objectives of IMF.
(iii) The functions of IMF.

Figures 5: IMF images

(a) IMF building	*(b) IMF logo*

Facts

The International Monetary Fund (IMF) is an international organization, headquartered in Washington, D.C., consisting of 189 countries working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world while periodically depending on the World Bank for its resources. Formed in 1944 at the Bretton Woods Conference, it came into formal existence in 1945 with 29 member countries and the goal of reconstructing the international payment system. It now plays a central role in the management of balance of payments difficulties and international financial crises. Countries contribute funds to a pool through a quota system from which countries experiencing balance of payments problems can borrow money.

Through the fund and other activities such as the gathering of statistics and analysis, surveillance of its members' economies, and the demand for particular policies, the IMF works to improve the economies of its member countries by helping them achieve macroeconomic stability and reduce poverty.

IMF funds come from two major sources: quotas and loans. Quotas, which are pooled funds of member nations, generate most IMF funds. The size of a member's quota depends on its economic and financial importance in the world. Nations with larger economic importance have larger quotas. The quotas are increased periodically as a means of boosting the IMF's resources in the form of special drawing rights.

The current Managing Director (MD) and Chairwoman of the IMF is Bulgarian economist Kristalina Georgieva, who has held the post since October 1, 2019.

Why the IMF was created and how it works

The IMF, also known as "the Fund", was conceived at a UN conference in Bretton Woods, New Hampshire, United States, in July 1944. The 44 countries at that conference sought to build a framework for economic cooperation to avoid a repetition of the competitive devaluations that had contributed to the Great Depression of the 1930s.

The IMF's responsibilities: The IMF's primary purpose is to ensure the stability of the international monetary system—the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other. The Fund's mandate was updated in 2012 to include all macroeconomic and financial sector issues that bear on global stability.

Objectives of IMF

1. To have a system with stable exchanges rates and avoid competitive devaluation.
2. To work towards the removal of forex control which hinders the growth of the world trade by establishing a multi-lateral system of payment in respect to carrying out transactional between member countries.
3. To ensure there is sufficient international liquidity and total means of payment acceptable for international payment.
4. Give advice to countries with balance of payment difficulties without resulting into measures destructive to national and international prosperity by making funds or resources available to them under adequate safe guards.

5. To facilitate extension and balanced growth of international trade and to contribute to the promotion and maintenance of high levels of employment and development of productive resources of all member countries.
6. To stabilise prices so as to increase the rates of economic growth and development among poor countries.
7. To increase the global co-operation through participation in international trade.
8. To harmonise policies pursued by different countries so as to create peace among member nations.

Functions of the International Monetary Fund

1. It gives technical advice to its member countries on monetary and fiscal policies in order to help member countries ensure economic stability.
2. Conduct some training services on fiscal and monetary as well as balance of payment issues for personnel from member nations through its Central banking service department.
3. Conduct research studies about member countries and publish the statistics about the balance of payment and other macro-economic statistics through the bureau of statistics and the IMF institutions.
4. IMF monitors the policies being adopted by the member countries. International payments and tariffs and ensure that no member country imposes restrictions on making that payment or trade restrictions without the approval of the IMF.
5. It ensures stable exchange rates by the member countries. I.e. it provides machinery for the orderly adjustments of exchange rates.
6. It helps member countries to offset BOP deficits by providing SDRs (special drawing rights) and the stabilisation fund to member countries faced with balance of payment problems.
7. It increases international liquidity by introducing the special drawing rights which can be used to finance deficit or surplus of balance of payment.

8. Buying and selling currency of the member countries and this assists debtor countries to purchase forex or to use SDRs in order to pay its debts. (SDRs are international reserve assets created by the IMF to supplement its member countries official reserves.) Its value is based on the basket of the currencies and it can be exchanged and freely usable by all countries. It is rather a potential claim on the freely usable currencies of the IMF members.
9. It functions as a short-term credit institution.
10. It is a reservoir of the currencies of all the member countries from which a borrower nation can borrow the currency of other nations.
11. It is a sort of lending institution in foreign exchange. However, it grants loans for financing current transactions only and not capital transactions.
12. The Fund contributes to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all member nations.
13. Assist countries to restructure their economies through SAPs facility.

Special drawing rights (SDR)

Special drawing rights (SDRs) are supplementary foreign exchange reserve assets defined and maintained by the International Monetary Fund (IMF). SDRs are units of account for the IMF, and not a currency per se. They represent a claim to currency held by IMF member countries for which they may be exchanged. It is a paper asset also known as paper gold created by IMF to increase international liquidity. SDRs were created in 1969 to supplement a shortfall of preferred foreign exchange reserve assets, namely gold and U.S. dollars. SDRs are allocated by the IMF to countries and cannot be held or used by private parties. Effective 1 October 2016, the SDR basket has consisted of the following five currencies: U.S. dollar 41.73%, euro 30.93%, renminbi (Chinese yuan) 10.92%, Japanese yen 8.33%, British pound 8.09%.

Use of SDRs

(i) SDRs are used to purchase members' own currency.

(ii) Overdrawing from SDRs will call for special IMF advice to countries concerned; which countries are faced with inflation and after the advice is devaluation.

(iii) It is used to settle international debt obligations by transferring credit to creditors. Countries with BOP surplus can receive SDR, in exchange for their own currency as an incentive to hold SDRs as the guaranteed interest.

Criticisms of IMF

The IMF faces a number of criticisms some of which are discussed below

- The IMF has put the global economy on a path of greater inequality and environmental destruction; The IMF's and World Bank' structural adjustment policies (SAPs) ensure debt repayment by requiring countries to cut spending on education and health; eliminate basic food and transportation subsidies; devalue national currencies to make exports cheaper; privatise national assets; and freeze wages. Such belt-tightening measures increase poverty, reduce countries' ability to develop strong domestic economies and allow multinational corporations to exploit workers and the environment.
- The IMF serves wealthy countries and Wall Street; Unlike a democratic system in which each member country would have an equal vote, rich countries dominate decision-making in the IMF because voting power is determined by the amount of money that each country pays into the IMF's quota system. It's a system of one dollar, one vote. The U.S. is the largest shareholder with a quota of 18 percent. Germany, Japan, France, Great Britain, and the US combined control about 38 percent. The disproportionate amount of power held by wealthy countries means that the interests of bankers, investors and corporations from industrialised countries are put above the needs of the world's poor majority.
- The IMF forces countries from the Global South to prioritise export production over the development of diversified domestic economies; Nearly 80 percent of all malnourished children in the developing world live in countries where farmers have been forced to shift from food production for local consumption to the production of export crops destined for wealthy countries.

- The IMF also requires countries to eliminate assistance to domestic industries while providing benefits for multinational corporations — such as forcibly lowering labour costs. Small businesses and farmers can't compete. Sweatshop workers in free trade zones set up by the IMF and World Bank earn starvation wages, live in deplorable conditions, and are unable to provide for their families. The cycle of poverty is perpetuated, not eliminated, as governments' debt to the IMF grows.
- The IMF is a secretive institution with no accountability; The IMF is funded with taxpayer money, yet it operates behind a veil of secrecy. Members of affected communities do not participate in designing loan packages. The IMF works with a select group of Central bankers and finance ministers to make polices without input from other government agencies such as health, education and environment departments. The institution has resisted calls for public scrutiny and independent evaluation.
- IMF policies promote corporate welfare; To increase exports, countries are encouraged to give tax breaks and subsidies to export industries. Public assets such as forestland and government utilities (phone, water and electricity companies) are sold off to foreign investors at rock bottom prices.
- The IMF hurts workers; The IMF and World Bank frequently advise countries to attract foreign investors by weakening their labour laws — eliminating collective bargaining laws and suppressing wages, for example. The IMF's mantra of "labour flexibility" permits corporations to fire at will and move where wages are cheapest.
- The IMF's policies hurt women the most; SAPs make it much more difficult for women to meet their families' basic needs. When education costs rise due to IMF-imposed fees for the use of public services (so-called "user fees") girls are the first to be withdrawn from schools. User fees at public clinics and hospitals make healthcare unaffordable to those who need it most. The shift to export agriculture also makes it harder for women to feed their families. Women have become more exploited as government workplace regulations are rolled back and sweatshops abuses increase.

- IMF Policies hurt the environment; IMF loans and bailout packages are paving the way for natural resource exploitation on a staggering/ amazing scale. The IMF does not consider the environmental impacts of lending policies, and environmental ministries and groups are not included in policy making. The focus on export growth to earn hard currency to pay back loans has led to an unsustainable liquidation of natural resources.
- The IMF bails out rich bankers, creating a moral hazard and greater instability in the global economy; The IMF routinely pushes countries to deregulate financial systems. The removal of regulations that might limit speculation has greatly increased capital investment in developing country financial markets. More than 1.5 trillion USD crosses border every day. Most of this capital is invested short-term, putting countries at the whim of financial speculators. Bailouts encourage investors to continue making risky, speculative bets, thereby increasing the instability of national economies.
- IMF policies imposed as conditions of these loans are bad medicine, causing layoffs in the short run and undermining development in the long run. This has sparked recessions in some countries by raising interest rates, which led to more bankruptcies and unemployment.

IMF Conditionalities

Activity 8

The IMF gives conditions to its member countries incase it is to give foreign aid to them.

(a) What conditions are they?

(b) How have these conditions impacted Rwanda's economy?

Usually before the IMF advances loans to its member countries, receiving the IMF loans, member countries must accept the conditionalities as prescribed in the structural adjustment programmes (SAPs). These IMF conditions have also been sometimes labelled as the Washington Consensus.

7.4.4 Structural Adjustment Programmes (SAPs)

Structural adjustment programmes (SAPs) refer to a package of policies which should be implemented in order to restructure and transform the economy of the country accepting loans from the IMF and the sister institution World Bank.

Structural adjustment programmes (SAPs) consist of loans provided by the International Monetary Fund (IMF) and the World Bank (WB) to countries that experienced economic crises. The two Bretton Woods Institutions require borrowing countries to implement certain policies in order to obtain new loans (or lower interest rates on existing ones). The conditionality clauses attached to the loans have been criticised because of their effects on the social sector.

SAPs are created with the goal of reducing the borrowing country's fiscal imbalances in the short and medium term or in order to adjust the economy to long-term growth. The bank from which a borrowing country receives its loan depends upon the type of necessity. The IMF usually implements stabilisation policies and the WB is in charge of adjustment measures.

SAPs are supposed to allow the economies of the developing countries to become more market oriented. This then forces them to concentrate more on trade and production so it can boost their economy. Through conditions, SAPs generally implement "free market" programmes and policy. These programmes include internal changes (notably privatisation and deregulation) as well as external ones, especially the reduction of trade barriers. Countries that fail to enact these programmes may be subject to severe fiscal discipline. Critics argue that the financial threats to poor countries amount to blackmail, and that poor nations have no choice but to comply.

The IMF conditions comprise of typical stabilisation and Long-term adjustment policies. They include among others the following:

1. Balance of payments deficits reduction through currency devaluation. i.e. member countries should devalue their currency to increase competition of home produced goods to increase foreign exchange earnings.
2. Privatisation or divestiture of all or part of state-owned enterprises: A country should privatise its large inefficient public enterprise which requires a lot of government funding leading to high government expenditure.
3. Budget deficit reduction through higher taxes and lower government spending, also known as austerity e.g. reducing on government expenditure on education and health in order to reduce the size of the work force to reduce on government expenditure hence has a balanced budget.
4. Retrenchment of the civil servants and demobilisation of the army in order to reduce on the size of the work force and government expenditure as well as ensure efficiency.
5. Increase on tax collection revenue to avoid deficit financing by simply printing more money.
6. Introduction of policies that attract both foreign and domestic investors, e.g, reduction in borrowing rates and having an open economy.
7. Infrastructural development in order to improve productivity thus promoting economic growth and development.
8. Emphasises the improvement of productivity through research and adoption of modern technology.
9. Market liberalisation to guarantee a price mechanism in order to avoid government control of prices which lead to inefficiency and to allow private producers to compete.
10. Market expansion through economic integration in order to increase export earnings.
11. Ensure political stability and security in the economy.
12. Raising food and petroleum prices to cut the burden of subsidies.
13. Forex liberalisation and granting autonomy to the central bank to pursue on appropriate monetary policy.

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

Applicability of SAPs in Rwanda

Some Structural Adjustments have been applied in Rwanda and these include among others the following:

- There has been improvement in tax correction through expanding the tax base by introducing new direct and indirect taxes.
- Trade liberalisation has been practiced in Rwanda e.g. markets have been opened for foreign imports especially manufactured commodities.
- Privatisation: Rwanda has privatised some of her public enterprises as one of the requirements of SAPs.
- There has been a reduction in public expenditure e.g. on social overhead expenditure like health, education social security etc. through cost sharing.
- As one of the IMF recommendations, there has been increased production in agricultural sector.
- Retrenchment of workers and demobilisation of the army.

Criticisms/impact of the SAPs conditionalities

The following are the criticisims or impacts of the SAPs conditionalities

1. Cost sharing has been introduced in institutions of higher learning leading to reduced enrolment in schools there by perpetuating illiteracy.
2. Cost sharing in hospitals has led to poor services hence poor health conditions leading to weak work force thus low output.
3. Removal of subsidises especially on food has deepened misery and suffering of the poor masses because they cannot afford basic necessities thereby destroying the workforce.

4. Life expectancy has dropped and the infant mortality rate has increased due to malnutrition and poor standards of living.
5. The SAPs policies have widened the gap between the rich and the poor e.g. through retrenchment hence increasing poverty among the majority of the poor.
6. The policy of devaluation has made imports expensive yet imports for LDCs have inelastic demand thus high forex expenditure or out flow worsening the balance of payment position.
7. The conditionalities have led to wide spread unemployment due to retrenchment and privatisation.
8. SAP's policies have led to the widening of the informal sector where the operator can try evading the taxes that the government has been forced to introduce.
9. The ruling parties and government in power have become unpopular because the implementation of these policies which are seen as being anti-people has at times led to strikes, riots and high crime rates.
10. SAPs threaten the sovereignty of national economies because an outside organisation is dictating a nation's economic policy.
11. When resources are transferred to foreign corporations and/or national elites through privatisation, the goal of public prosperity is replaced with the goal of private accumulation.
12. SAPs are held responsible for much of the economic stagnation that has occurred in borrowing countries. SAPs emphasise maintaining a balanced budget, which forces austerity programmes. The casualties of balancing a budget are often social programmes yet they are already underfunded and desperately need monetary investment for improvement. e.g. education, public health, and other social safety nets.

7.5 International Bank for Reconstruction and Development (IBRD)- the World Bank

Activity 9

Basing on the research carried out in activity 6 of this unit, discuss amongst yourselves about the following:

(i) What led to the establishment of the World Bank?

(ii) The objectives of World Bank,

(iii) Its functions and criticisms.

(iv) What is the major difference between IMF and World Bank?

Figure 6: World Bank images

(a) World Bank building

WORLD BANK

(b) World Bank logo

Facts

The International Bank for Reconstruction and Development (I.B.R.D) better known as the World Bank was established at the same time as the International Monetary Fund to tackle the problem of international investment in 1944. Since the I.M.F was designed to provide temporary assistance in correcting balance of payments difficulties, there was need of an institution to assist long term investment purposes. Thus I.B.R.D was established for promoting long term investment loans on reasonable terms. The World Bank as an inter-government institution corporate forms the capital stock of which is entirely owned by its member governments. Initially only nations that were members of the I.M.F could be members of the World Bank but the restriction on membership was subsequently released.

The World Bank advances loans to member countries primarily to help them lay down the foundation of sound economic growth. The loans made by the bank either directly or through guarantees are intended for certain specific projects of reconstruction and development in the member countries.

Members of I.B.R.D/WB

The International Bank for Reconstruction and Development (IBRD) has 189 member countries, while the International Development Association (IDA) has 172 members. Each member state of IBRD should also be a member of the International Monetary Fund (IMF) and only members of IBRD are allowed to join other institutions within the Bank (such as IDA)

a) Objectives of I.B.R.D/WB

The objectives of I.B.R.D as incorporated in the Articles of Agreement are as follows:

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

b) Functions of I.B.R.D/WB

The principal functions of the I.B.R.D are set forth in Article (1) of the Agreement as follows:

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

c) Projects supported by World Bank in Rwanda

Moving forward, the World Bank Group is expanding its support to Rwanda, helping it shift its growth trajectory that has the private sector at its vanguard. This requires much investment in infrastructure, service delivery, accountable governance, regional integration, boosting agricultural productivity, etc. To help Rwanda respond to these challenges, the World Bank Group has built its current portfolio of a net commitment of almost 887 million USD for 11 national projects and six regional projects with a national commitment of 204 million USD. These projects include:

- Rwanda Pilot Programme for Climate Resilience.
- Third Social Protection System Support (SPS-3).
- Rwanda Urban Development Project.
- Rwanda Electricity Sector Strengthening Project.
- Transformation of Agriculture Sector Programme Phase 3 for Rwanda.
- Rwanda Public Sector Governance Programme for Results.
- Landscape Approach to Forest Restoration and Conservation (LAFREC).

- Second Demobilisation and Reintegration Project—Additional Financing.
- Rwanda Feeder Roads Development Project.
- Rwanda Third Rural Sector Support Project Additional Financing.
- Land Husbandry, Water Harvesting and Hillside Irrigation.
- Third Rural Sector Support Project.
- Rwanda Electricity Access Additional Financing.

Criticisms of the IBRD/WB

Below are the criticisims of the IBRD/WB:

- The World Bank would promote world inflation and "a world in which international trade is state-dominated".
  The so-called free market reform policies that the bank advocates for are often harmful to economic development if implemented badly, too quickly ("shock therapy"), in the wrong sequence or in weak, uncompetitive economies.
- The World Bank has been criticised on the way in which it is governed. While the World Bank represents 188 countries, it is run by a small number of economically powerful countries. These countries (which also provide most of the institution's funding) choose the leadership and senior management of the World Bank, and so their interests dominate the bank.
- In the 1990s, the World Bank and the IMF forged the Washington Consensus, policies that included deregulation and liberalisation of markets, privatisation and the downscaling of government. Though the Washington Consensus was conceived as a policy that would best promote development, it was criticised for ignoring equity, employment and how reforms like privatisation were carried out. The Washington Consensus placed too much emphasis on the growth of GDP, and not enough on the permanence of growth or on whether growth contributed to better living standards.
- The World Bank and other international financial institutions focus too much on issuing loans rather than on achieving concrete development results within a finite period of time
- It has been criticised on the grounds that traditionally, WB has always been having Americans head the bank because the United States provides the majority of World Bank funding.

Unit assessment

1. (a) What role has the IMF played in economic development of your country?
   (b) What structural adjustment programmes have been implemented in your country?

2. (a) What are foreign Direct Investments (FDI's)? Give examples in Rwanda?
   (b) Examine the contribution of FDI's in the development process of Rwanda.
   (c) Examine the barriers to FDI inflows in Rwanda.
3. (a) Explain the roles of World Bank.
   (b) Identify different sectors supported by World Bank in Rwanda.

Glossary

- **Globalisation**: A process by which most economies around the world have become more interdependent, especially to increased integration of financial market.
- **International Bank for Reconstruction and Development (World Bank) (IBRD)**: Established in 1945 to serve as a vehicle for making loans to less developed countries. Loans are made from the bank's capital, created by the subscriptions of members and by the sale of bonds.
- **International Monetary Fund (IMF)**: Established by the Allied Nations in 1944 to stabilise exchange rates and encourage world trade by reducing exchange restrictions. It lends money to nations with balance of payments deficits. It affects international monetary reserves through the creation of Special Drawing Rights (SDR's). Over 100 nations belong to IMF.
- **Special Drawing Rights (SDRs)**: International monetary reserves created by IMF and made available to its members. It is also called paper gold.

Unit summary

- Global business organisations
  - Meaning of globalisation
  - Characteristics of globalisation
  - Causes of globalisation
  - Effects of globalisation
  - Multinational corporations (MNCs)
  - Foreign Direct Investment (FDIs)
- Global Financial Systems
  - Bretton Woods Conference
  - International Monetary Fund (IMF)
  - International Bank for Reconstruction and Development (IBRD) / the World Bank (WB)
  - Structural Adjustment Program

Topic Area 5: Development Economics

Sub-Topic Area 5.1: Economic Growth and Development

UNIT 8

Economic Growth, Development and Underdevelopment

Key unit competence: Learners will be able to analyse the indicators and determinants of economic growth and development in an economy.

My goals

By the end of this unit, I will be able to:

- Explain the meaning of economic growth, development and underdevelopment.
- Examine the factors that determine economic growth and development.
- Analyse the importance of growth to the economy.
- Compare the balanced, unbalanced and big push strategies of growth.
- Analyse the advantages, disadvantages, limitations and applicability of the theory to Rwanda .
- Compare and contrast the stages, limitations and applicability of Rostow's and Marxist's theories of growth.
- Examine the differences between economic growth, development and underdevelopment.
- Analyse the types of poverty and their causes.
- Suggest policy measures that can be taken by the government of Rwanda to reduce the rates of poverty.

8.1 Economic Growth

Activity 1

Figure 1: Economic growth aspects in Rwanda

Case study 1

Relating to the photos in figure 1 above, the economy of Rwanda has grown tremendously since 1994. For example, there has been drastic increase in agricultural activities thus increasing food production, trade and business, infrastructure like schools, hospitals, and many roads linking rural areas to urban centres. Many Rwandans now are able to access education, get treatment, move from one place to another and have meals throughout the day.

Basing on the photos in figure 1 and case study 1 above, discuss the questions that follow;

(i) Name the economic activities portrayed in the images in figure 1 above.

(ii) What do you think is term used to mean the increase in the number such economic activities shown in figure 1 and named in the case study above?

(iii) What factors do you think have helped Rwanda to achieve the situation seen in the images and described in case study 1 above?

(iv) Examine the advantages the scenario described in figure 1 and case study 1 have on Rwanda.

(v) Analyze the problems that the above scenario brings to Rwanda.

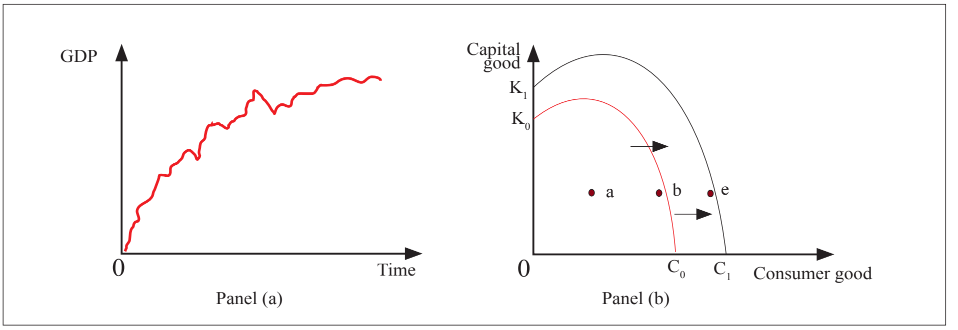
Facts

Economic growth can be defined as the quantitative increase in the volume of goods and services, or the persistent increase in the volume of goods and services over a period of time. Some economists define economic growth as the persistent increase in the country's Gross Domestic Product. (GDP).

Economic growth is a material concept. It concerns itself with the growth of physical output, and does not take into account non-material factors like stress, happiness, etc. It is generally considered that economic growth does cause an increase in the standard of living provided that the increase in production exceeds any increase in the population.

This concept of economic growth is usually illustrated by an outward shift of the production possibility curve or production possibility frontier. The production possibility curve is a locus of points showing combinations of two goods that a country can produce when all its resources are fully and efficiently utilised. The outward shift of the curve illustrates an increasing capacity to produce goods and services.

Figure 2: Economic growth trends



The curve K_0C_o shows all possible combinations of capital and consumer goods available to a nation when all resources are fully employed.

Point **a** represents unemployment of some resources, under-utilisation or excess capacity. Point **b** indicates full employment of all resources, while **e** represents economic growth. A movement from **a** to **b** or any other point on the curve represents an increase in real income. An outward shift of the Production Possibility Frontier (**PPF**) from $\mathbf{K_0C_o}$ to $\mathbf{K_1C_1}$ illustrates economic growth.

8.1.1 Measuring of economic growth (Calculation of economic growth)

Growth is usually calculated in real terms - i.e., inflation-adjusted terms to eliminate the distorting effect of inflation on the prices of goods produced. Measurement of economic growth uses national income accounting since economic growth is measured as the annual percent change of gross domestic product (GDP). Therefore, Gross domestic product is the best way to measure economic growth since it takes into account the country's entire economic output. It includes all goods and services that businesses in the country produce for sale. It doesn't matter whether they are sold domestically or overseas.

When measuring economic growth, unpaid services, child care, unpaid volunteer work, or illegal black-market activities and the environmental costs and how they impact the well-being of society are not considered. We only measure what is valued therefore, economic growth rate uses real GDP. When real GDP is growing over time, then the country is experiencing economic growth and the reverse is true when real GDP is falling.

Trend of economic growth in Rwanda.

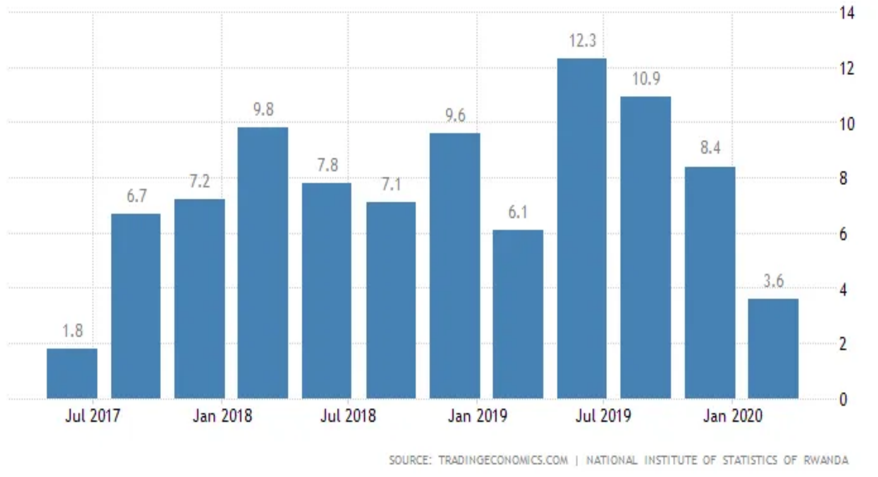
Rwanda's economic growth slowed to 3.6% year-on-year in the first quarter of 2020, compared to 6.1% in same period last year, and 8.4% in the last quarter of 2019. That was the slowest pace of growth since the second quarter of 2017, occasioned by effects of the global COVID-19 pandemic. Among the sectors whose performance deteriorated during the period include agriculture, industry, and service. The sectors' growths were as follows:

Table 1: Sector contribution to economic growth in Rwanda

SECTOR	Q1 2020	Q4 2019
Services	6%	8%
Transportation	No growth	12%
Hotel & Restaurants	3%	12%
Financial services	-5%	13%
Professional, scientific & technical activities	-1%	9%
Cultural, domestic & other services	-1%	5%
Industry	2%	14%
Mining & quarrying	-26%	-12%
Manufacturing	6%	9%
Construction	5%	33%
Agricultural activity	-1%	5%
Production of export crops	-16%	-4%
Food crops	-2%	4%

On a quarterly basis, the Rwanda GDP contracted 4.2%, following an upwardly revised 1.1% growth in the previous quarter.

Figure 3: Rwanda GDP growth rate:



At the beginning of this year, the International Monetary Fund (IMF) projected trade and private investment to boost Rwanda's GDP by 8%.

In the past, Rwanda has recorded impressive economic growth. Improved performance in construction, manufacturing, and its service industry saw Rwanda's GDP grow by 11.9% in 2018 Q3. The government and IMF estimated its 2019 growth at 8.5%. The country recorded a double-digit growth of 12.2% in 2019 Q2.

8.1.2 Factors that determine economic growth

Economic growth is the increase in the capacity of an economy to produce goods and services within a specific period of time. It is actually a long-term expansion in the productive potential of the economy to satisfy the wants of individuals in a society. Economic growth is directly related to percentage increase in GNP of a country. In real sense, economic growth is related to increase in per capita national output or net national product of a country that remain constant or sustained for many years. Therefore, any factor that affects real GNP of a country affects economic growth. When these factors are favourable, they increase economic growth but when they are unfavourable, they affect economic growth adversely.

It should be noted that economic growth does not depend on a single factor but a proper balance and management of all the factors involved.

These factors are economic, political, social and cultural in nature. The following are some of the important factors that affect economic growth of a country:

- Human resource: The quality and quantity of available human resource can directly affect the growth of an economy. The quality of human resource is dependent on its skills, creative abilities, training and education. If the human resource of a country is well skilled and trained, then the output would also be of high quantity and quality. On the other hand, a shortage of skilled labour hampers the growth of an economy, whereas surplus of labour is of a lesser significance to economic growth. Therefore, the human resources of a country should be adequate in number with required skills and abilities, so that economic growth can be achieved.
- Natural resources: This involves resources that are produced by nature either on the land or beneath the land e.g. plants, water resources and landscape, oil, natural gas, metals, non-metals and minerals. These depend on climate and environmental conditions. Countries having plenty of natural resources enjoy good growth than countries with small amount of natural resources. Also, efficient utilisation or exploitation of natural resources depends on the skills and abilities of human resource, technology used and availability of funds. Therefore, a country having skilled and educated workforce with rich natural resources takes the country on the path of growth than the one with out.
- Capital formation: This involves land, building, machinery, power, transportation and medium of communication. Producing and acquiring all these man-made products is termed as capital formation. Capital formation increases the availability of capital per worker, which further increases capital/labour ratio. Consequently, the productivity of labour increases, which ultimately results in the increase in output and growth of the economy. On the other hand, a reduction in the rate of capital formation negatively affects the rate of economic growth.

- Technological development: This involves the application of scientific methods and production techniques. In other words, technology is the nature and type of technical instruments used by a certain amount of labour. Technological development helps in increasing productivity with the limited amount of resources. Countries that have worked in the field of technological development grow rapidly compared to countries that have less focus on technological development.
- The selection of right technology also plays an important role for the growth of an economy. On the other hand, an inappropriate technology results in high cost of production thus affecting economic growth adversely.
- Social and political factors: social factors involve customs, traditions, values and beliefs which contribute to growth of an economy. For example, a society with conventional beliefs and superstitions resists the adoption of modern ways of living. In such a case, achieving growth becomes difficult. If a society is flexible towards modern ways of living, achieving growth is quicker and easier. Also, political factors, such as participation of government in formulating and implementing various policies, have a major part in promoting economic growth.
- Local and foreign Markets availability: The presence of market both local and foreign, makes suppliers find a way to increase production to satisfy the expanded market through increased demand. This will be witnessed through increased investments throughout the country in a bid to make more supplies and increase their profitability. On the other hand, the absence of market will discourage producers, lead to closure of some industries in the country etc. thus low production in general affecting economic growth negatively.

- Foreign capital (foreign aid and foreign investment): As domestic savings are not sufficient to make possible the necessary or desired accumulation of capital goods, borrowing from abroad may play an important role. This helps to supplement a country's own small saving in its growth process. Foreign capital can be loans or through foreign direct investments by foreign companies which also help to accelerate economic growth in the receiving country through capital accumulation and higher productivity of labour. They, also, promote new advanced technologies and technical know-how which are required for industrial growth and building up of infrastructure, such as power, irrigation facilities, ports and telecommunications all necessary to aid productivity in an economy. However, if foreign assistance is not forthcoming in adequate quantity, then a country experiences serious difficulties in promoting economic growth as productive capacity of the economy will be rendered inappropriate and inefficient.
- This means that, absence of sufficient borrowing and direct foreign investment and the economic growth of the country will be adversely affected.
- The growth of population: The growing population increases the level of output by increasing the number of working population or labour force provided all are absorbed in productive employment. Increase in population means increase in quantity of labour and also increase in demand for goods which encourages production in the economy due to an expanded market. This promotes large-scale production and thus reaping of economies of large scale production. However, it should also be noted that, a growing population will increase productivity only if there is availability of supplies of natural and capital resources and the prevailing technology. When the supplies of capital and other resources are meagre, the increase in population will merely add to unemployment and will not bring about an increase in national output this hinders economic growth instead of promoting it. In another view, population growth adds a number of mouths to be fed and this raises consumption and therefore lowers both saving and investment thus holding down the rate of economic growth in a country.

- Political situation: This is a crucial factor that affects economic growth in any given economy. When there is good political climate i.e. political stability and security of a country attracts both local and foreign investors. Thus increases the volume of goods and services produced. People are assured of security for themselves and their property and this motivates them to start up or expand their businesses in different parts of the country promoting more productive potentials and a positive change in economic growth of a country. In another view, political stability and security in a country reduces government expenditure on military hardware and other forms of financing wars which increases government expenditure on productive activities through development expenditure. Production capacity of the country increases leading to increase in economic growth. On the other hand, political instability and insecurity scares away potential investors, both local and foreign, and also increase government expenditure on financing wars, buying military hardware etc.
- All which reduce the production potentials of a country leading to low production of goods and services and adverse effect on economic growth.
- Availability of entrepreneurs: Presence of large number of entrepreneurs will lead to invention of new methods of production which will increase output compared to where there are few entrepreneurs. Entrepreneurs are always willing to convert new ideas into successful innovations. This creates new products and new business models which increase the productive capacity of the people leading to increased productivity hence promoting economic growth of a country.
- Infrastructural development: Infrastructure involves transport network, communication facilities, power, banking institutions etc. Therefore, well-developed and evenly distributed socio-economic infrastructure in an economy will attract more investments by both local and foreign investors since it makes it easy for movement of producers from one place to another and exchange of goods and services to and from different parts of the world hence increasing productivity and output distribution. On the other hand, poorly developed and un fairly distributed socio-economic infrastructure will discourage both local and foreign investments therefore reducing the productive capacity of the nation hampering economic growth.

- Government policy of subsidisation and taxation: When the government adopts a conscious policy of promoting production like giving producers subsidies, tax holidays, reducing interest rate on borrowing etc., investments will be attracted leading to increase in the volume of goods and services produced in the country. Where as the government takes on policies that are not friendly to producers like over taxing these, unfair allocation of resources, high interest rate on borrowed funds etc. it will discourage investments and lower production potentials in the country thus hampering economic growth.
- Technological change: New knowledge and inventions can contribute markedly to growth of potential output, even without net capital accumulation. If the old capital is merely replaced in the same form, capital stock will be constant and there will be no increase in the capacity to produce.
- However, if there is growth of knowledge so that as old equipment wears out, it is replaced by different and more productive equipment, productive capacity will be growing leading to economic growth.

8.1.3 Merits/benefits of economic growth

In order to maintain the current living standards, productive capacity must grow at a faster rate than the rate of increase in population. As the economy grows, industries expand, new ones get established, and employment opportunities also expand. This becomes easy for government to redistribute income, provide more services and more opportunities for the less fortunate. Therefore, a number of benefits can be derived from a high rate of economic growth as explained below:

- An increase in standard of living: Economic growth can maintain or improve the living standards. In the long-term, economic growth is the primary engine for raising general living standards. Growth means a higher material standard of living for the citizens of the country. It means more goods and services — cars, shoes, necklaces, foreign holidays, etc. It can help to tackle the poverty of the disadvantaged groups in society though there is no guarantee that this will automatically result from growth. It will probably require action by government to ensure that the benefits of growth are widely shared.

- A higher level of public expenditure with no need for higher taxation: In most cases, increases in government expenditure exceed increases in the national income. This necessitates for a higher level of taxation to finance the increased expenditure. However, if there is a high rate of economic growth then government revenue would automatically increase without any increase in the rate of taxation. Economic growth is the best way to finance more government expenditure.
- Growth and redistribution of income: When there is economic growth and when the increment in income is redistributed through government intervention, it is possible to reduce income inequalities without actually having to lower anyone's income. It is much easier for a rapidly growing economy to be generous toward its less fortunate citizens or neighbours, than it is for a static economy.
- Reduction in balance of payment problems: A faster rate of growth will make it easier to achieve a balance of payment equilibrium. An increase in output reduces pressure on prices, increases domestic demand and foreign demand for exports which improves the balance of payment position of a country.
- Creates and widens employment opportunities: An expanding economy will have a high level of capital investment spending that will help to sustain a high level of employment. New industries will be emerging and existing ones expanding thus increase in economic activities. This reduces the problem of unemployment and the rates of poverty and its related problems.
- Technological advancement: Economic growth involves advances in technology, innovation and a high degree of dynamism in the economy. This increase in efficiency is likely to be reflected in the quality of the country's goods, and will make them more competitive in export markets. Besides, the volume of imports reduces, thereby improving the balance of payments position.
- Health related issues are reduced: There is increased production of goods and services which are vital to society and this helps to reduce malnutrition and other related diseases. This keeps the population healthy and more productive thus promoting more growth in the economy.

- Widens the tax base of the country: Once there is expansion of different economic activities in the economy, the country's tax base increases through taxing those different economic activities hence increasing revenue to the government that can be used for development.
- Economic independence is attained: Since the country produces a lot of goods and services, it reduces reliance on other countries for assistance. Wide variety of commodities produced in the country enables its population to get most of their requirements at home and only gets what they cannot produce with their available resources.
- Infrastructure development: Infrastructures such as roads, hospitals and schools among others are developed to facilitate production directly or indirectly which leads to the development of the country.
- Promotes industrialisation and urbanisation: Economic growth encourages setting up of more industries and the expansion of the existing ones in order to increase productivity. This leads to growth of urban centres since so many facilities such as banking services, roads, power, water, telecommunication services, health centres, training centres etc. are set up in such areas to aid industrial production.
- Stabilises prices in the economy: Wide variety of goods produced reduce price fluctuations as long as supply matches demand in and outside the country. And also as a result of much output, general price level of goods and services will reduce which increases real incomes of the citizens.
- Promotes political stability: With people being engaged in different economic activities and the desire to produce more and earn more, they have no reason to be chaotic and more so, have little or no time to waste as in rebelling against the ruling government. People who are well off and have a variety to consume, have no food conflicts which is a major cause of insecurities.

8.1.4 Costs of economic growth

The benefits of economic growth are truly impressive. This fact explains why economic growth is so ardently pursued by so many countries. The advantages of economic growth, however, should not obscure the reality that economic growth has costs as well as benefits. As the process of economic growth gets under way, and more goods and services are produced each year, there may arise certain undesirable side effects. If these are not incurred by the producers in the form of higher costs of production, then they are termed social costs. Social costs are those costs arising from economic activity that are borne by society and not by the producer.

Other things being equal, most people would probably regard a fast rate of growth as preferable to a slow one. In spite of the benefits associated with economic growth, there are also costs to material growth. These costs to society can be explained as follows:

- Pollution of air and water: The industries set up to produce and persistently increase output level produce fumes that pollute the environment and pour waste in the water bodies, there is also noise out of those machines. The present serious pollution problem according to the critics, results directly from rapid economic growth. As long as we pursue the goal of more economic growth, they conclude, we will continue to damage the environment.
- Environmental degradation: There is over exploitation of the natural resources which leads to their quick depletion. The ecosystem is normally tempered with, like, swamps being reclaimed, deforestation occurring so as to give room to industries that produce and persistently increase output level to attain economic growth. This reduces environmental sustainability.
- Congestion of traffic and houses leading to delays and easy disease spread: Traffic congestion occurs as vehicles are ever flowing in and out of the industrial place causing unnecessary delays. Workers in the industrial place tend to be accommodated near industries causing slum areas around and poor sanitation.
- Erosion of cultural values: In order to attain faster rates of economic growth, nationals tend to adopt foreign ways of consumption, behaviour and general living, this costs the nation discipline and order that had been maintained for long.

- Current consumption is normally foregone: People, in order to save enough, create capital assets that produce output to attain economic growth, always forego current consumption. They always feel that, to increase output and achieve greater economic growth, one should lower current consumption. This reduces health and living standards of the citizens that further worsens productive capacities and negatively affects economic growth.
- People forego leisure: Leisure is an important aspect of improved standard of living so as to always work, increase output and attain economic growth. However, economists also argue that a greater output of goods and services will not help us to achieve the good life. This is because, on the contrary, people feel that a greater real gross domestic product can be achieved only by sacrificing leisure.
- Increased indebtedness of developing countries: In order to attain economic growth, most developing countries borrow to set up production ventures that produce and persistently increase the level of economic growth. This increases a country's indebtedness.
- Industrial/occupational hazards: Several upcoming industries set up to attain economic growth do not provide protective gadgets to the workers. Consequently, workers inhale poisonous fumes causing them chronic diseases. Also, they sometimes lose body parts to the machines they are not oriented to.
- The dangers of rural urban migration: As more industries are set up, people move to towns to get jobs and better living conditions in urban areas. As such, likely negative effects arise, such as slum development, open urban unemployment, and overcrowdings arise; this is mainly because people leave villages for urban settings where industries are set up fight for attainment of economic growth.
- Technological unemployment: Another aspect of social cost arises from new techniques of production. Machines and production methods will be subject to a fairly rapid rate of obsolescence. This is also true for labour. The changes which make economic growth possible also make labour redundant. This is especially the case with the capital-intensive techniques which rapidly increase the output level but make labour redundant. This causes technological unemployment.

8.1.5 Measures to promote economic growth

Measures that may be taken to promote long-term economic growth include among others:

- Human capital formation: The government can encourage investment in human capital by providing scholarships, educational grants, and loans to students on favourable terms. Financial support to colleges and universities will also help to improve the quality of human capital and thus promote economic growth.
- Technological change: The government can promote technological change by encouraging Research and Development (R & D). A number of private firms undertake research and development.
- The government can provide incentives to these and other firms to increase their research and development activities. It can also finance some research and development projects of its own.
- Encouraging investment: The government can foster economic growth by encouraging investment. This can be attained partly through interest rate policies (low interest rates tend to stimulate real investment), and partly through tax incentives for investment in plant and equipment.
- Transfer of surplus labour from agriculture: One step a less developed country can take to promote economic growth is to remove surplus labour from the agricultural sector to more productive use in other sectors.
- Use of modern technology in agriculture: Attempts should be made to introduce modern technology into agriculture. This could be in form of new types of seeds and improved farming methods. This would lead to dramatic increases in agricultural production.
- Population control: Almost all developing countries use population control methods as part of their attempt to break out of the underdevelopment trap. Population control programmes have two elements: the provision of low cost birth control facilities and the provision of incentives encouraging people to have a small number of children. These methods meet with some, but limited success. Their efforts have been greatly aided by the World Health Organisation (WHO). Steps to increase the quality of their labour resources through education and training have also been taken. These measures have helped promote growth and development in less developed countries. Without these measures, the plight of these countries would have been worse.

- Foreign aid: The idea that foreign aid helps economic development arises from a simple consideration. If a poor country is poor because it has too little capital, then by obtaining aid, it can accumulate more capital and achieve a higher per capita output. Repeated applications of foreign aid year after year can enable a country to grow much more quickly than it could if it had to rely exclusively on its own domestic saving. By this line of reasoning, the greater the flow of foreign aid to a country, the faster it will grow.
- Removal of trade restrictions: By permitting unrestricted trade with underdeveloped countries, rich countries gain by being able to consume goods that are imported at lower prices than would be possible if only domestic supplies were available. Developing countries gain by being able to sell their output for a higher price than would prevail if they had only the domestic market available to them. Some of the most dramatic economic growth and development success stories have been based on reaping the gains from relatively unrestricted international trade. Countries such as Singapore and Hong Kong have opened their economies to free trade with the rest of the world and dramatically increased their living standards by specialising and producing goods and services at which they have a comparative advantage — which they can produce at a lower opportunity cost than other countries.
- Improve the general climate for growth: The government can attempt to improve the climate for growth in a number of ways as for instance; lower tax rates in the hope of increasing incentives for work and risk taking; reduce the extent of government interference and a greater role for the free market will create the environment for economic growth; keep down home market prices; market provision; improve the general infrastructure and create security.

8.1.6 Circumstances under which economic growth may take place without corresponding levels of economic development

Activity 2

Basing on the Case Study 1 of this unit, it is seen that there has been increase in the volumes of goods and services, schools and hospitals have been built among others. Still, the standard of living of the people has not moved hand in hand with growth meaning economic growth is not moving at the same speed with development.

As a whole class, discuss the reasons for this trend in most developing countries.

Facts

- Economic growth can give rise to a persistent increase in the volume of goods and services produced with little or no quality added at all, under such circumstances economic growth is attained minus economic development.
- Economic growth makes people overwork at the expense of leisure, for economic growth to be attained at hyper rates people must work without rest; this negatively affects their welfare since leisure is part of one's standard of living.
- Economic growth may be achieved at high rates but when the country is producing ammunitions to support the ongoing war. Even then economic growth is attained minus a corresponding rate of economic development.
- Economic growth may be achieved but when people are still using traditional tools and under developed technology, there is no economic development in such a situation because people struggle much to raise such a level of output.

- Economic growth may be attained but when people's mode of thinking and attitude towards work have not yet changed from that of a back ward primitive set up. Such a reasoning mode delays economic development.
- Economic growth may be achieved but with high rates of pollution from industries set up to attain it. The pollution denies the society development.
- Economic growth can be attained but when the country is producing capital goods that do not have a direct impact on the standard of living of the people. In such a situation, economic development delays.
- Economic growth may be attained but with benefits in the hands of a few capital owners. Due to the uneven distribution of resources, such a society does not achieve economic development.
- Economic growth may be achieved internally but when such output is exported and nationals do not experience its benefits, even then economic development is not achieved.
- There may be improper accountability. The government officials may embezzle benefits of the high rates of economic growth attained. Such corruption practices delay economic development.

8.2 Theories of Growth

The theories of growth attempt to show the causes, sources and stages of economic growth and they have been developed from the developed nations to show the stages they passed through and how far they have gone. Different economists have grouped these theories into two broad categories

1. Theories based on sector balancing. Here they devised three major theories as seen below;
   (a) Balanced growth theory
   (b) Unbalanced growth theory
   (c) Big push theory.
2. Theories based on causes of growth. Here they devised three other theories as seen below;
   (a) Rostow's stages of growth
   (b) Dependence theory
   (c) Marxist theory of transformation.

Figure 4: Theories of Economic Growth

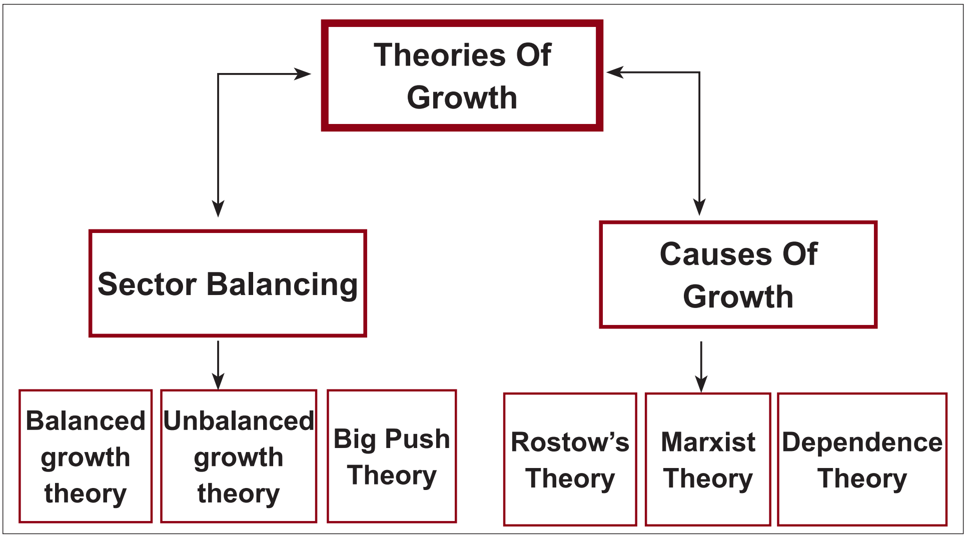


Figure 4 above illustrates the theories of growth basing on the causes of growth and sector balancing

8.2.1 Theories based on sector balancing

Like said earlier these theories have been developed basing on developed countries and they have been found to be a bit hard to apply in the East African countries like Rwanda, Kenya, Tanzania, Burundi, Uganda and South Sudan. These include the following;

1. Balanced growth theory

Activity 3

Use library textbooks or internet to carry out research and attempt the following questions:

(i) What is a balanced growth strategy?

(ii) Explain the advantages and disadvantages of balanced growth strategy?

(iii) Analyse the limitations of applying the balanced growth strategy in Rwanda?

Facts

Meaning of balanced growth

Balanced growth strategy was advocated for by *Ragnar Nurkse* in the article "The problem of capital formulation in developing countries". It states that there should be a simultaneous and harmonious upbringing of all sectors in an economy so that they grow at a more or less the same pace. The theory advocates for a *critical minimum effort* which is the minimum level of investment or sacrifice required in all the sectors of the economy to ensure interdependence and self-sustaining growth.

Nurkse proposes that industries which complement each other through linkages should be established and developed at the same time and rate in terms of demand and supply of raw materials. This will provide market for each other either raw materials or in puts. For example, balance should be made in the following sectors;

(a) Capital goods industries and consumer goods industries,
(b) The industrial sector and agricultural sector,
(c) Social overhead capital (transport, power, water, education, health facilities) and productive activities. (agriculture, industry and services).
(d) The rural sector and the urban sector,
(e) Production for market and production for export,
(f) Labour intensive techniques and capital intensive techniques etc.

Arguments in favour of the balanced growth theory

Below are the arguments supporting the balanced growth theory:

- It encourages resource exploitation and utilisation because it creates high demand for these resources by the many sectors in operation.
- The theory widens the tax base of the country because all the developed sectors are taxed by the government.
- It encourages forward and backward linkages in the economy since some sectors provide raw materials while others provide market for those raw materials.

- Employment is created because of the increased demand for labour to work in the different developed sectors.
- Balance of payment position may be improved especially when production is for export.
- Development in technology is undertaken because of the need to produce good quality goods and services.
- Self-reliance is created since all sectors are developed at the same time and there are a variety of goods and services needed in the society.
- It reduces income inequality because most of the people are engaged in the production of goods and services.
- Brain drain is reduced because the people are able to find employment in the country.
- Foreign exchange is saved because there is little to import since the economy is self-sustaining.

Disadvantages of the balanced growth theory

The following are the disadvantages of the balanced growth theory:

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

Limitations of the balanced growth theory

Below are the limitations supporting the balanced growth theory:

- A balanced growth strategy requires a lot of capital funds which are not yet available in LDCs.
- Developing countries do not have adequate skilled manpower to scatter in all sectors being developed at the same time.

- A balanced growth strategy requires proper planning and implementation of plans so as to coordinate the different projects running at the same time, developing countries are not blessed with such planning skills.
- A balanced growth strategy requires developed infrastructure in terms of transport and telecommunication network, hydroelectric power, among others, such developed infrastructure is still inadequate in LDCs, and so they cannot sustain a balanced growth strategy.
- Developing countries have underdeveloped technology; it is still traditional and sometimes just intermediate that cannot support the growth of a balanced growth strategy.
- LDCs have inadequate local and foreign market, such a market cannot support the much output from all sectors of the economy, it goes to wastage hence losses.

Application in Rwanda

Most development and growth theories are based on the experience of the people who develop them. The balanced growth strategy has been found inapplicable to Rwanda basing on the arguments below:

- The theory is based on the assumption that all sectors in the economy are underdeveloped at the same level. This is not the case because in Rwanda some sectors are far more developed than others and the developed sectors are having linkages and pulling the rest that are lagging behind.
- Rwanda does not have the "critical minimum effort" that is minimum level of investment required to develop all the sectors at once. It can only afford a few sectors at a time. Developing agriculture, industry and all other sectors will require large sums of money that is lacking.
- Rwanda does not have the necessary resources both in terms of capital and human resources and related to that is the technology. With these lapses, the theory cannot be applicable due to the deficiencies.
- The theory does not consider the enormous planning that is required to ensure that the development process does not harm the economy. There has to be planning to ensure that there is equilibrium in the economy where demand and supply are equal because if one is greater than the other, they might develop imbalances and this may create inflation and surpluses. Planning is still a major problem in all developing countries at large.

- The theory assumes that industries and other sectors complement each other but this is not true, because in real terms, the sectors compete with each other for resources like labour, raw materials, market etc.
- The size of the market in Rwanda is still small meaning that when all sectors are developed at the same time, the massive production may cause surpluses and wastage. Still the foreign market maybe small due to the quality of the goods that are produced.
- Attempts to develop all the sectors in the economy may cause inflation. This is because it will call for increased expenditure in the economy which will cause increased money supply leading to demand pull and monetary inflation among others.
- The theory ignores the principle of comparative advantage. Rwanda may not be able to develop all the sectors at the same time but it may look at that sector that it can incur the least opportunity cost and then import other goods from other countries.

2. Unbalanced growth theory

Activity 4

Use the library or internet to contact a research about the following;

(i) Meaning of an unbalanced growth strategy.

(ii) The advantages and disadvantages of the unbalanced growth strategy.

(iii) The limitations of applying the unbalanced growth strategy in Rwanda.

Facts

Meaning of unbalanced growth theory

The Unbalanced Growth theory was popularised by *Albert. O. Hirschman*. According to this growth strategy, *investment should be made in strategically selected sectors rather than simultaneously* in all sectors of the economy. Investment should be made in a few selected sectors or industries for rapid development. This will lead to disequilibrium, creating scope for new investment opportunities, and thus, this would create inducement to invest. One disequilibrium calls for development which leads to another disequilibrium and then to the next one and so on. This is the path of development, an under developed country has to follow which according to the proponents of the unbalanced growth theory. This is the path of development on under developed country has to follow. The economies accruing from these few industries can be utilised for the development of other sectors. According to this strategy, unbalanced growth is the best way to achieve economic growth in an underdeveloped economy since these countries lack enough resources. Development can take place by unbalancing the economy such that the developed sectors will expand and others are developed at a later stage.

Hirschman emphasises the importance of international trade as a means of helping LDCs out of a vicious cycle of poverty. He proposed heavy investment in social overhead capital which reduces the costs of production thus encouraging productive activities at a later stage.

Advantages of the unbalanced growth theory

The following are the advantages of the unbalanced growth theory:

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

Demerits of the unbalanced growth theory

Below are the demerits of the unbalanced growth theory:

- It slows the rate of economic growth since the output from the few sectors is low and may not serve the whole nation at large. This may lead to constant importation.
- Regional inequalities come up because some areas will develop at the expense of others hence creating dualism with its associated problems.
- Unemployment may come up since few sectors are developed and worse still the sectors may resort to capital intensive technology to produce good quality.
- The theory encourages dependence because the country cannot satisfy the needs of its people thus it keeps on importing what it cannot produce hence worsening the balance of payment position.
- Leading sectors may not be able to pull others hence they will develop at the expense of others since they may not be compatible.
- Less tax revenue will be collected from the few sectors leading to constant borrowing with its associated problems.
- Some resources will remain idle since the developed sectors cannot use them as resources hence under utilisation.
- A decline in one or two sectors will affect the economy drastically since it has no alternative sectors to run to.
- There will be brain drain since few people will be employed creating a vacuum in the country since the would be skilled people have fled in search for greener pastures.

Limitations of the unbalanced growth theory

The following are the limitations of unbalanced growth theory:

- The strategy emphasises specialisation which has several weaknesses like limited varieties. This limits choice and development, total loss in case of failure among others.
- The strategy limits employment opportunities, one or a few sectors promoted can employ only a few people, with special skills. This will limit employment opportunities.
- The strategy denies the economy a chance to diversify which is a great input to development.

- Developing countries have a limited size of the market which cannot consume all the output from the sector being emphasised all over the country, so it leads to wastage of resources.
- The strategy encourages dependency on other nations, the output missed from the neglected sectors is to be imported. This worsens dependency and the balance of payment problems in the country.
- The emphasised sector may fail to have a serious impact on the country. Worse still it may just make it underdeveloped the more.
- The strategy may make the neglected sectors to lag so behind that uplifting them later may be so expensive or even hard, and this further widens the gap between the sectors of the country.

Application in Rwanda

Since the theory calls for development of a few sectors first so that others follow, the Rwandan government has put this to its advantage due to the little resources it has. The government has embarked on massive investment in sectors that link areas. A case in point is the massive construction of roads to connect places. Secondly, sectors like education and agriculture among others have been developed. Below are the instances that show applicability of the theory:

- Rwanda has limited resources and therefore it has been able to develop a few leading sectors like transport education and agriculture while the rest are also following and having linkages.
- In Rwanda, planning is being carried out to develop a few sectors first as seen in the current budget that calls for increased infrastructure development so as to encourage linkages.
- In Rwanda, the theory has encouraged specialisation which in turn is helping to create employment opportunities and skill development.
- The difference in resource endowment has made the theory more applicable in Rwanda. It is unwise to develop the all the sectors like agriculture, fishing, mining among others. Due to resource inadequacy, Rwanda has embarked on developing more agriculture compared to fishing.
- The unbalanced growth strategy has helped Rwanda to participate in foreign trade more so as to get what it cannot produce. Rwanda is actively participating in the East African community and other trade organisations. This has created international relations.

3. Big push theory

Activity 5

Use library materials or internet and research about the following:

(i) The meaning of the big push theory.

(ii) The advantages and disadvantages of the big push theory.

(iii) The limitations of applying the big push theory in Rwanda.

Facts

Meaning of big push theory

The Big push theory was advanced by an economist called ***Paul Rodenstein Rodan*** and this explains why some economists prefer calling it the ***Rodanian theory.*** The theory states that; "for developing countries to take off into self-sustaining and dynamic economic growth, they need a massive investment programme in industrialisation and building up economic infrastructure".

This is a theory that assigns to capital the central role in the process of economic growth and development. Big-Push or a large comprehensive programme is needed in the form of a high minimum amount of investment to overcome the obstacles to development in LDCs. There should be a high minimum level of resources that must be devoted to a development programme if LDCs are to come on the path of economic progress.

The theory opposes proceeding "bit by bit", as proposed by professor W.W. Rostow, because it will not launch the economy on the development path. The Big-Push calls for a sudden sharp increase in the rate of investment so as to put LDCs on the path of economic progress. This could be done by mobilising savings. The sudden increase in the rate of investment would require government action and direction since the majority of people in LDCs are unable to establish industrial firms. Big-Push necessitates obtaining external economies that arise from simultaneous establishment of technically interdependent industries. It also requires investment in social overhead capital at a large scale. Besides, the Big-Push theory requires a sizeable market to ensure favourable returns.

Arguments in favour of the big push strategy

Below are the arguments in favour of the big push theory:

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

Disadvantages of big push theory

The disadvantages of the big push theory can be seen discussed below:

- The theory calls for massive expenditure, such funds are not readily available in LDCs, it calls for borrowing from other nations and this increases the indebtedness of LDCs.
- The big push theory ignores the role of agriculture in development. Agriculture is the major supplier of foodstuffs and raw materials to agro-based industries that developing countries can sustain.

- The massive industrialisation that Rodan advocates for increases pollution that reduces the quality of life of the people.
- The theory calls for over exploitation of the natural resources due to the massive industrialisation, this leads to their quick depletion.
- The heavy industrialisation and economic infrastructural growth brings about the use of machines in production, these replace labourers, causing technological unemployment.
- The massive industrialisation required by the theory calls for the rich foreign investors to developing countries, these repatriate all profits to their home countries leaving LDCs in a worse state than they found them.

Limitations of the big push theory

The big push theory has numerous challenges some of which are shown below:

- There is inadequate funds and man power in LDCs to invest in the theory.
- LDCs have inadequate resources to act as raw materials. This may be a hindrance to the development of industries.
- Developing countries do not have adequate skilled manpower to scatter in all sectors being developed at the same time.
- The strategy requires proper planning and implementation of plans so as to coordinate the different projects running at the same time, developing countries are not blessed with such planning skills.
- Strategy requires developed infrastructure in terms of transport and telecommunication network, hydroelectric power, among others. Such developed infrastructure is still inadequate in LDCs, and they cannot as such sustain a balanced growth strategy.
- Developing countries have underdeveloped technology; it is still traditional and sometimes just intermediate that cannot support the growth strategy.
- LDCs have inadequate local and foreign market, such a market cannot support the much output from all the industries of the economy, it goes to wastage hence losses.

Application in Rwanda

Like in other developing countries, the theory is not applicable to Rwanda based on the following arguments:

- The theory assumes that financial resources are available to massively invest in all sectors at once, and this isn't the case in Rwanda.
- Excess spending may lead to inflation in the short run when the there is more demand of goods than supply.
- Output resulting from the high investments may lack market both domestic and foreign thus creating unwanted surpluses and wastages.
- Resources in Rwanda may not be readily available to be exploited at the same time since Rwanda has a problem of resource inadequacy.
- Some industries can only develop after others have grown, so it may be hard to develop all of them at the same time. e.g. the leather industry can only develop after the livestock industry has developed; Sugar industries can develop after the sugar cane firms have developed, etc.
- In Rwanda, there is still inadequacy in the labour force to coordinate and manage the various productive activities initiated.

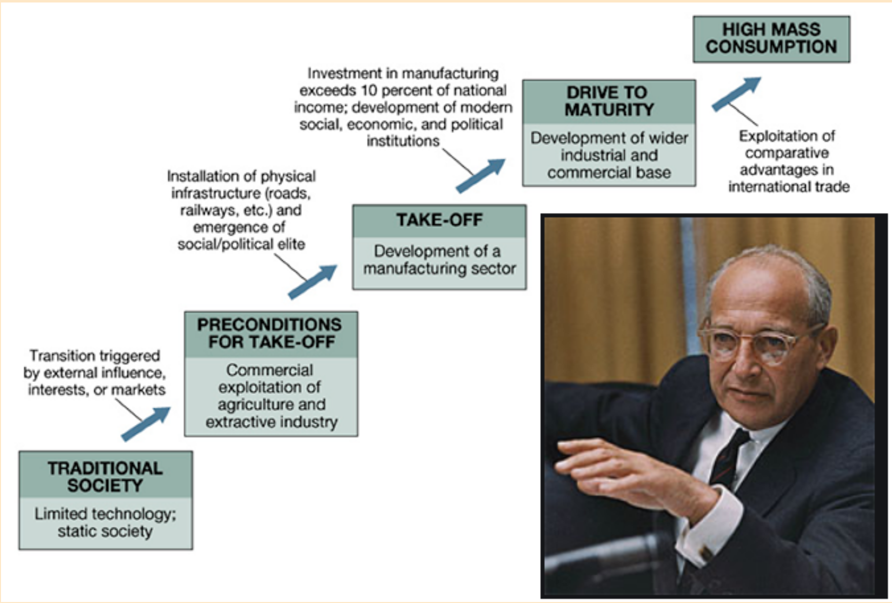
8.2.2 Theories based on causes of growth

The theories based on the causes of growth tend to show the stages that the countries passed through to where they are now. They tend to concentrate more on how the developed nations reached where they are. Further, some theories such as the dependence theory, tend to explain more, why some countries have continuously lagged behind in terms of growth and development. There are basically three theories under the causes of growth and these are discussed below.

1. Rostow's stages of growth

Activity 6

Figure 5: Rostow's stages of growth



Prof. Whitman Walt Rostow

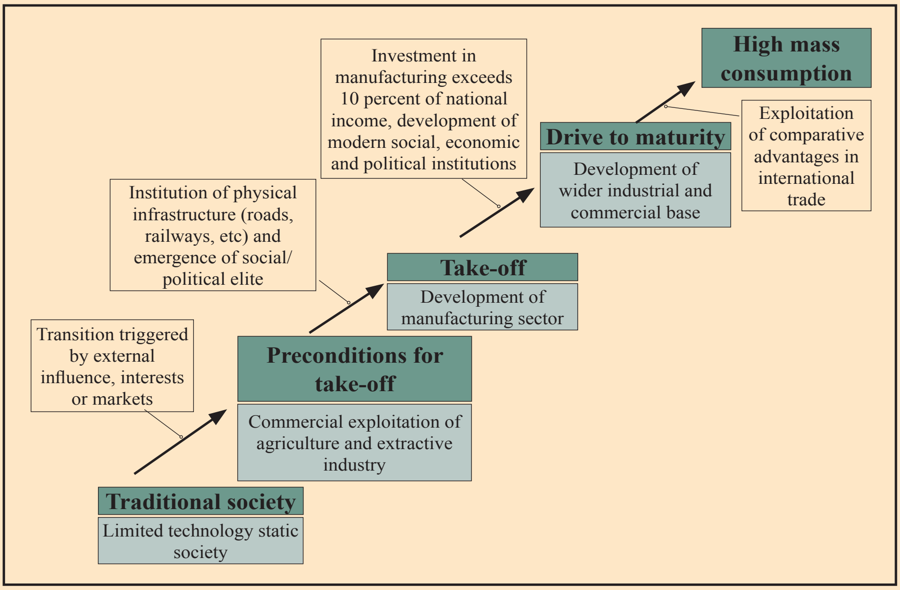
With reference to the images in figure 6 above, visit the library or internet or any other economics resource to research and thereafter in class through discussion,

(iv) State Rostow's view on economic growth.

(v) Identify the stages of growth according to Rostow named above.

(vi) Describe the different characteristics of each Rostow's stage of growth.

(vii) Discuss the extent to which the theory is applicable in developing countries' economies.



Rostow's stages of growth

Facts

Professor Walt Whitman Rostow is one of the pronounced development economists. After studying the trend of economic development in various countries, he came up with the conclusion that, development follows specific stages. He postulated that the transition from underdevelopment to development can be described through 5 gradual stages or steps. He described these stages together with the features through which all countries pass to attain hyper rates of economic growth and development. i.e. from primitive stage to the last stage he called it the mass high consumption stage. These stages depict the way of life, way of doing work, level of capital accumulation, method of production, level of saving and investment among others.

Professor W.W. Rostow emphasises capital accumulation as a driving force of the economy through these gradual stages.

Rostow's stages of economic growth

- Traditional stage
- Transitional stage
- Take off stage
- Drive to maturity stage

- Stage of high mass consumption

Traditional stage

This is the first stage in the development process where the economy is still in infancy and there is little progress taking place. It has the following features:

- Subsistence production where output is for home consumption.
- No use of money as a medium of exchange.
- There is a high degree of communal organisation where people work together as a community.
- Traditional beliefs in culture lead to a lot of conservatism.
- There are cases of disease and the nearest hospital is the bush.
- Production is highly labour intensive.
- There is almost no formal employment and organised income.
- There is nothing like investment and savings in the economy and the economy is closed from external world.
- High levels of resource wastage through unproductive activities like funeral rites, birth cerebrations, marriage, etc.

Transitional stage/pre-condition to take off

The societies are in the process of transition. It is the period when the society lays the foundation for take-off and never to revert to the traditional era. The society is first influenced by the external forces from MDCs. The idea of economic progress spreads. The society then starts to imitate the advanced society. In this stage, the following features exist:

- Dualism arises at this stage. Dualism is the co-existence of two contradicting sectors in an economy, one developed and the other under developed. e.g. commercial agriculture versus subsistence agriculture, agriculture versus industry.
- The society starts moving away from dominant subsistence sector and traditional methods of production are reduced.
- A market economy starts emerging where people exchange their output for money.
- Industrialisation starts more so the processing industry, these are normally agro-based industries processing agricultural output.
- Entrepreneurs start to emerge.

- Saving and investment start and rise up to 5% of the Gross Domestic product.
- Development of a national identity and shared economic interests.
- Mobility of labour begins.
- Education starts spreading.
- Banks and other institutions for mobilising capital appear.
- Investments in communications and manufacturing take place.
- Entrepreneurs start to emerge. i.e. new enterprising people come forward to mobilise savings.

Take off stage to self-sustained growth stage

Self-sustained growth means a reduction on foreign dependence. This is the stage when the obstacles to steady growth are finally overcome. The forces of economic progress from the modern economic activities expand and dominate the society. The economy becomes self-propelling. This stage involves rapid transformation in the country's social, cultural, political and economic spheres. It has the following characteristics:

- Barriers to development are eliminated. Strong economic infrastructure like banks, hospitals, schools are set up.
- Savings and investment grow to between 5% and over 10% of the Gross Domestic Product, new industries are introduced and industrial growth takes faster rates.
- More employment opportunities are created; people's incomes rise because wages are higher.
- Idle resources are put to more efficient use through exploitation by the industries.
- Modern and advanced technology is introduced in all sectors of the economy.
- Skilled and qualified labour and entrepreneurs start coming up.
- Education and literacy rates increase at faster rates.
- Rate of urbanisation increases faster.
- Both industrialisation and markets expand.
- One or more leading sectors of the economy develop.
- The increase in per capita output should outstrip the growth of population.

Prematurity stage/Drive to maturity stage (self-sustained growth)

The growing economy drives to extend modern technology over all the economic activities. It is a period of long sustained economic growth. New production techniques replace the old ones and new sectors are created. This stage has the following features:

- The rate of saving and investment is between 10% and 20% of GDP.
- The economy undergoes fundamental political, social and economic advancements, technology progresses rapidly.
- Production for export grows further and there is limited importation of manufactured goods.
- The industrial sector is transformed from small scale to heavy industrialisation.
- Agricultural mechanisation emerges and such heavy agricultural machines like tractors, combine harvesters, multi crop thresher are used to increase agricultural productivity.
- There is maximum utilisation of the country's resources.
- Modernisation of the economy is very high and traditional norms, beliefs and customs are kicked away.
- There are high levels of employment opportunities and white collar jobs increase in availability.
- Goods formerly imported are produced at home with import substitution industrial strategy.
- New import requirements develop and new export commodities to match the imports develop.
- The character of entrepreneurship changes to a better one.
- Real wages start rising.
- It is at this stage that the economy demonstrates its technological and entrepreneurial skills to produce anything it may choose.

Stage of high mass consumption

This is the last stage in growth where the economy has reached its climax. It is the stage when the leading sectors of the economy shift from producing mainly capital goods to producing consumer goods. The incomes of the majority rise beyond what is necessary for subsistence. The structure of the population changes from being predominantly rural to predominantly urban. It has the following characteristics:

- All resources in the country are fully exploited and utilised.
- Consumer durables like washing machines, cookers etc become necessities in every household.
- Incomes of the people are extremely high due to full employment conditions.
- Industrial growth is at its peak and they start producing luxuries like cosmetics, necklaces among others.
- The rates of saving and investments are over 20% of gross domestic product.
- There are high rates of exportation and the country's balance of payment position improves.
- Urbanisation increases thus increase in the urban population.
- A country starts lending and donating to other nations.
- People reduce working hours and start enjoying leisure, they even start going abroad to tour and rest.
- There is more allocation of funds to social welfare and social security than to industry which leads to the emergence of a welfare state.
- The proportion of the population working in offices or skilled factory jobs dominates the working class.

Note

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

Applicability of the theory in low developing countries

As talked about by Rostow, developing countries have tended to go through the same path though there is still a long way to go. The following features can be seen in the developing countries:

- Subsistence production where output is for home consumption is very common in developing countries as a means for survival.
- No use of money as a medium of exchange. In some areas, exchange is through barter system while generally money is used as a medium of exchange in all societies.
- There is a high degree of communal organisation where people work together as a community through cooperatives.

- Traditional beliefs in culture lead to a lot of conservatism. This is very common in developing countries and it has led to low quality output.
- Production is highly labour intensive and this is because of the inadequacy in capital in developing countries.
- High levels of resource wastage through unproductive activities like funeral rites, birth cerebrations, marriage etc. are common practices in developing countries.
- Dualism is common. Dualism is the co-existence of two contradicting sectors in an economy one developed and the other under developed. e.g. commercial agriculture versus subsistence agriculture, agriculture versus industry.
- Industrialisation is common especially the processing industry. These are normally agro-based industries processing agricultural output, as mentioned in the pre-conditions to take off stage.
- Entrepreneurs are emerging and this has increased saving and investment leading to increase of the gross domestic product.
- There are high cases of labour mobility in the developing countries both internal and external.

Criticisms of Rostow's theory

Rostow's theory of growth is criticised as shown below:

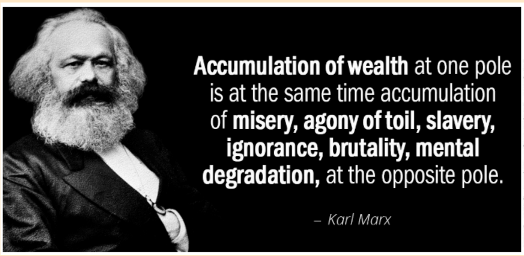
- Rostow talks about progressing from stage to stage but does not show the mechanism of how it is done.
- Some countries have already entered into the last stage of the age of High Mass consumption before going through the fourth stage of maturity, e.g. Canada, Australia.
- Rostow bases his theory on American and European history and defines the American norm of high mass consumption as an integral to the economic development process to all industrial societies, so his model has no impact on other nations especially the developing agricultural nations.
- Rostow fails to demarcate one stage from the other as the features especially stage one and stage two; and stage four and five tend to overlap into each other. So it is difficult to demarcate one stage of growth from the other.

- Some countries have achieved high savings – 5 to 15% — but they have never taken off.
- Rostow does not appreciate that some countries were born free of some stages. Rostow does not consider nations like U.S.A and Canada, which were born free of the traditional stage.
- Rostow bases his theory on savings, showing that growth occurs as the rate of savings increase with advancing stages but savings do not show a picture of economic growth because they are autonomous.
- Whitman Rostow gives rates of savings and investment at different stages but does not show how the rates are determined, so they become unrealistic.

2. Marxist theory of growth

Activity 7

Figure 6: Marxist stages of growth



Stage	Oppressing Class	Oppressed Class
Primitive Communism	No classes = No Conflict	
Slavery	Slave Owners	Slaves
Feudalism	Landowners	Serfs
Capitalism	Bourgeoisie	Proletariat
Socialism	State Managers	Workers
Communism	No Classes = No Conflict	

Karl Marx1818-1883

With reference to the images in figure 6 above, visit the library or internet or any other economics resource to research and thereafter in class,

(viii) State the Marxian view of growth.

(ix) Identify the stages of growth according to Carl Marx named above.

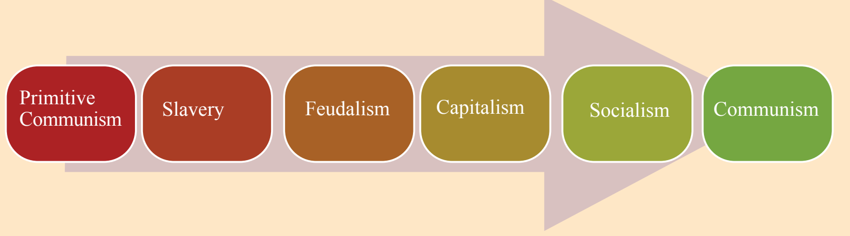
(x) Describe the different characteristics of each Marxist's stage of growth.

Assumptions of Marxian economic theory of growth:

The theory is based on certain assumptions.

3. There are two principal classes in the society. i.e. Bourgeoisie and Proletariats.
4. Wages of workers are determined at subsistence level of living.
5. Labour theory of value holds good. Thus labour is the main source of value generation.
6. Factors of production are owned by the capitalists.
7. Capital is of two types: constant and variable capital.

Stages of history



Facts

According to Karl Marx, development grows through stages that are determined by class struggle. He also developed five stages like Rostow and although the stages were different he also agreed that development started from nowhere, where everything was primitive, what he called the traditional stage.

The difference between him and Rostow was that while Rostow emphasised the role of saving and capital accumulation, Karl Marx advocated for the importance of labour as an engine to growth:

Karl Max's stages of growth

- Traditional stage
- Slave economy
- Feudal economy
- Capitalism
- Socialism and Communism

Traditional stage

This is the first stage and has got the following characteristics:

- A generally peasant economy where simple activities for home consumption are carried out.
- Communal ownership of land i.e. land is owned by the whole community.
- No use of money as a medium of exchange.
- Traditional beliefs in culture lead to a lot of conservatism.
- Production is direct for home consumption.
- Family labour is used in the production process.
- The output produced is little.

Slave economy

This is the second stage and has the following characteristics:

- Private ownership of resources like land emerge.
- There is ownership of people as property.
- Slaves are used as free labour to increase output.

Feudal economy

This has the following features:

- Under this land is owned by the kings and other cultural leaders.
- Cultural leaders have a task of collecting tax revenue which may be in form of produce within their respective areas and present it to the kings.
- People pay for use of land through the output produced.

Capitalism

The capitalist economy has the following characteristics:

- There is increased competition in the markets.
- Emergence of monopolies in form of big multinational corporations.
- Forces of demand and supply determine what is to be produced.
- Profit motivation is the major determinant of production.
- Government role is to regulate the production activities but participates less in the production process.
- Increased use of machinery causing technological unemployment.

Socialism and communism

This economy is characterised by the following:

- Increased mechanised worsening the unemployment problem.
- Creation of an army of the employed emerges due to high rates of unemployed.
- The workers tend to take over the states and their main aim is to distribute wealth.
- There are riots and strikes against the government.
- Ultimately socialism leads to communism where by the state withers away and there will be no shortage of products.

3. Dependence theory

Activity 8

Visit the library or the internet or any other economics resource and research on the dependence theory. Thereafter, share through class discussion, the following;

a) What do you understand by the term dependence?
b) How does the theory describe the growth trend?
c) In which ways do the poor nations depend on rich nations for their growth?
d) Why do you think developing nations have continued to be dependent on developed nations?
e) How has the dependence of the poor 'peripheral' countries on the rich 'core' affected the growth trend of the former?

Facts

According to the dependency theory, the wealth of the richer nations increases at the expense of the poorer ones. In its extreme form, dependency theory is based on a Marxist view of the world, which sees globalisation in terms of the spread of market capitalism, and the exploitation of cheap labour and resources in return for the obsolete technologies of the developed world. The dominant view of dependency theorists is that there is a dominant world capitalist system that relies on a division of labour between the rich 'core' countries and poor 'peripheral' countries. Over time, the core countries have exploited their dominance over an increasingly marginalized periphery. Therefore, developing countries' continued reliance on developed nations for financial, resource, trade and decisional support in their growth path.

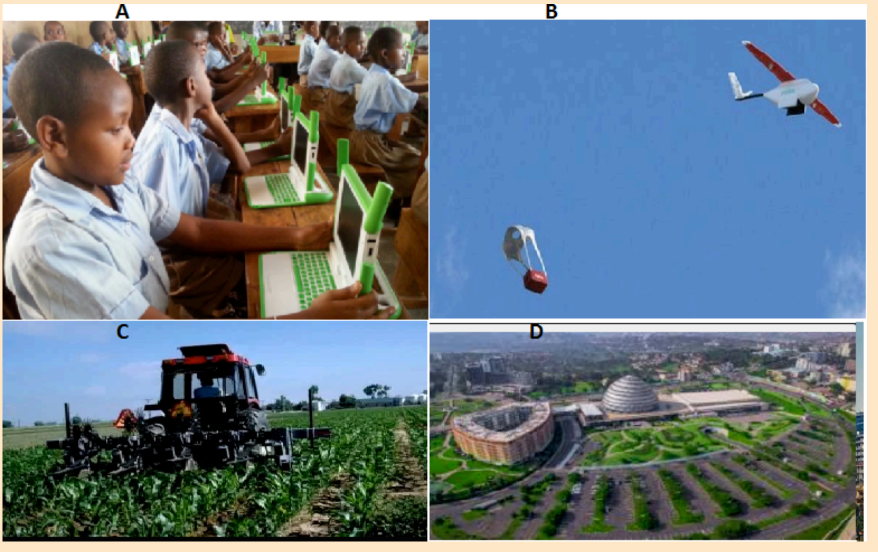
Dependency theory advocated an inward-looking approach to development and an increased role for the state in terms of imposing barriers to trade, making inward investment difficult and promoting nationalization of key industries.

Although still a popular theory in history and sociology, dependency theory has disappeared from the mainstream of economic theory since the collapse of Communism in the early 1990s. The considerable inefficiencies associated with state involvement in the economy and the growth of corruption, have been dramatically exposed in countries that have followed this view of development, most notably a small number of African economies, including Zimbabwe.

8.3 Economic Development

Activity 9

Figure 8: Economic development



Case study 2

Twenty-five years ago, the Genocide against the Tutsi left Rwanda far behind on all development indicators and its entire socio-economic fabric destroyed. Rwandans embarked on a rebuilding process driven by a shared Vision 2020 based on three fundamental choices: unity, ambition, and accountability. The country undertook several reforms aimed at creating an inclusive and fair society with respect of human rights and rule of law. Since 2000, Rwanda has registered inclusive growth, averaging 8% annually leading to millions being lifted out of poverty and good progress in all development sectors.

There has been improvement in the quality of education and learning; progress on nutrition thus tending towards eradication of malnutrition; Inclusive economic growth with a reduction in both income and multidimensional poverty; Environment and climate change with an aim of seeing Rwanda become a green, climate resilient and low carbon economy by 2050; Good governance and access to justice with citizen participation and home-grown solutions such as Imihigo (performance contracts) and Umuganda where communities come together to perform activities of public interest. Rwanda has also operationalized a decentralized civil registration system and reformed its judicial system to further enhance access to quality justice. More efforts are put into domestic resource mobilization, prudent debt management and macroeconomic stability.

Analyse the photos in figure 8 above and case study above and answer the questions that follow.

(i) What do the photos & case study above depict as far as the Rwandan economy is concerned?

(ii) Which sectors are shown in the photos above?

(iii) From the case study and images above what are the indicators of development in Rwanda?

(iv) What did it take the government of Rwanda to achieve the above developments?

(v) Why do you think is the logic behind Rwanda's urge to attain the above and more other developments?

(vi) With reference to Rwandan economy, describe how the increase in her productive capacity doesn't necessarily imply improvement in the quality of life of her citizens.

Facts

8.3.1 Meaning of economic development

Economic development refers to the sustained quantitative and qualitative increase in the volume of goods and services produced over a period. It is normally accompanied by positive social, economic, and political institutional changes that may improve the quality of life of individuals. It can also be defined as the process by which real GNP per-capita increases quantitatively and qualitatively over a very long period of time in the country. The term development is wider than economic development or social economic welfare or material wellbeing because it includes improvements in economic, social and political aspects of the whole society.

Development means meeting basic needs, reducing poverty, inequality and unemployment, raising living standards, improving access to education, raising life expectancy and expanding economic and social choice through appropriate economic growth. Todaro (1988) identifies three objectives of development:

1. Increases in the availability and improvements in the distribution of food, shelter, health, protection, etc.
2. Improvements in 'levels of living,' including higher incomes, more jobs, better education, etc.
3. Expansion in the range of economic and social choices available to individuals and nations.

Development must be conceived as a multi-dimensional process involving changes in structures, attitudes and institutions as well as the acceleration of economic growth, the reduction of inequality and eradication of absolute poverty. The goals of development include: a balanced, healthful diet; adequate medical care; environmental sanitation and disease control; labour opportunities; sufficient educational opportunities; individual freedom of conscience and freedom from fear; descent housing; economic activities and harmony with the natural environment, and social and political processes promoting equality.

8.3.2 Human development

Human development is economic and other dimensions like social and political. Hence human development implies improvements in a wide range of indicators for example literacy, security, involvement in community, self-esteem, freedom and participation. The process of expanding people's choices and the level of well-being, they are at the core of the notion of human development. Human development is a broader and complex concept and it means that people:

1. Lead long and healthy lives;
2. Are knowledgeable;
3. Have access to the resources needed for a decent standard of living;
4. Enjoy political, economic and social opportunities for being creative and productive;

5. Have freedom from fear and enjoy self-respect, empowerment and a sense of belonging to a community.

8.3.3 Measuring economic development

The UN has four human development indices:

- Human Development Index (HDI): This measures the average achievements in a country through three basic dimensions of human development: longevity, knowledge and a descent standard of living. The variables used to show these dimensions are life expectancy, educational attainment and real gross domestic product per capita. But regardless of the level of development, the three essentials include the ability to lead a long and healthy life, to acquire knowledge, and to have access to the resources needed for a descent standard of living. Human development does not end there, people also highly value political, economic and social freedom, opportunities for being creative and productive, self-respect and guaranteed human rights.
- Gender-related Development Index (GDI): This measures achievements in the same dimensions and variables as the HDI does, but takes account of inequality in achievement between women and men. The greater the gender disparity in basic human development, the lower a country's GDI compared with its HDI.
- Gender Empowerment Measure (GEM): This indicates whether women are able to actively participate in economic and political life. It focuses on participation, measuring gender inequality in key areas of economic and political participation and decision-making. It thus differs from the GDI, an indicator of gender inequality in basic capabilities.
- Human Poverty Index (HPI): This measures deprivation in basic human development in the same dimensions as the HDI. The variables used to show these dimensions are the percentage of people expected to die before the age of 40, the percentage of adults who are illiterate, and the overall economic provisioning in terms of the percentage of people without access to health services and safe water and the percentage of underweight children under five.

8.3.4 Economic development and its requirements

Economic development is a process involving growth, qualitative and structural changes in the economy. It is an economic phenomenon, which is identified by many more parameters than increases in the national income and income per capita. With economic development, there must be:

1. A movement from subsistence production to monetary production;
2. A transformation of the economy from one being dominated by agriculture into one dominated by industry; there should be a change in the composition of goods;
3. Technological progress and;
4. Increase in the volume of savings.

The general requirements for development include the following:

- An indigenous base: If the process of economic growth and development is to be achieved and maintained, the forces of development must be firmly rooted within the domestic economy, with the change in the mindset of people.
  This means that, the growth process must have a domestic base within the underdeveloped economy. Development cannot be implanted from outside however much forces outside the economy can stimulate and facilitate the indigenous forces but cannot maintain it.
- Structural changes: Economic development requires that there should be a transition from a traditional agricultural society, primary production, rural life, etc. to a modern industrial economy, urbanised and tertiary employment, that involves a radical transformation of existing institutions, social attitudes, and motivations. This change would lead to increasing employment opportunities, higher labour productivity and the stock of capital, exploitation of new resources and improvements in technology. There should be radical changes of land reforms, improved agricultural techniques; transport and credit facilities; better marketing organisation etc., all allow these higher wages, higher incomes, and higher standards of living.

- Socio-cultural requirements: The socio-cultural attitudes of the people should be changed if development is to take place. Social organisations like the extended families, kinship, religious dogmas and rural life should be modified so that they may be more favourable to development.

  This is done through wide spread education which leads to enlightenment, opens people's minds to new methods and new techniques of production and enables one to think rationally. There must emerge a group of business administrative and political leaders who can be depended upon to maintain the momentum of development by constant innovation.
- Administration: A good administration, which is strong, competent and in-corrupt is needed to stimulate economic development through proper resource allocation into productive projects. There should also be maintenance of internal law and order and defending the country against external aggression.
- Capital accumulation: There should be an efficient banking system to mobilise savings and channel them into productive projects so as to accumulate capital. Where domestic resources are not enough, it is necessary to import foreign capital in the form of loans or foreign aid from MDCs.
- Infrastructure: It requires well developed infrastructures like electricity and/or natural gas, paved roads, reliable railroads, modern telecommunication systems, modern airport facilities and other different physical infrastructure which aid production and industrialisation.
- A suitable investment criterion: Investment should be directed towards the most productive projects that will make the maximum use of labour and domestic raw materials. Such investments should be those to produce goods for meeting the basic needs of the people and promote greater external economies for the growth of other industries and reduce pressures on balance of payments. The various sectors of an economy should grow in harmonious way so that no sector lags behind or moves far ahead of others.

- Development of human resources: For economic development to be achieved, there should be an increasing number of persons who have the skills, education and experience which are critical for the economic and political development of a country. Therefore, governments should enable individuals to acquire the basic skills required in the labour market. This however requires change in the education system to one which is more practical oriented.
- Control of population: Family planning programmes, marriage age laws, economic incentives and disincentives, formal and informal education, are some of the methods for controlling population. This enables government to match population growth with available resources.
- Development of the export sector: Foreign exchange can be obtained to import capital for setting up industries that can provide employment opportunities.
- Institutions: Economic development requires a more advanced legal and institutional setting like strict banking regulations, laws governing contracts, stock issues, debt obligations, and bankruptcy which are necessary to ensure that business transactions can be undertaken with minimum risk thus generate sustained growth.

8.3.5 Objectives/goals of development

- To reduce on illiteracy rates and improve on literacy levels among the citizens in the country.
- To attain higher rates of economic growth as shown by the increase in the gross domestic product.
- To attain price stability/fight against inflationary tendencies in an economy so as to create certainty in the markets.
- To reduce economic dependency or to attain self reliance so as to reduce excess capital outflow and at the same time develop local production ventures.
- To fight against unemployment so as to reduce poverty and improve on people's standards of living.
- To attain even resource distribution so as to reduce income inequalities among the people and regions.

- To improve upon skills of the people through education and development to reduce dependence on foreign experts who seem expensive.
- To improve upon security to life and property and to ensure a good political atmosphere that will attract investors.
- To control population growth rates to desirable levels so as to reduce its associated problems.
- To attain equilibrium of the balance of payment position through increasing and improving upon the volume and value of exports and reducing spending on imports.

8.3.6 Indicators of economic development

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

8.3.7 Comparison between economic growth and development

- Economic growth may involve the increase in the GDP only while economic development involves both quality and quantity.
- Economic growth may take place even with poor income distribution while development involves faith income distribution.
- Growth can take place even with poor quality while development involves good quality output.

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

Note

Development and economic growth are not identical to one another. Economic growth may occur without achieving the goals of development.

8.4 Underdevelopment

Activity 10

Study the pictures above and.

a) State what economic attachment is put into the above pictures.
b) What are the distinguishing features of countries that live in such conditions.
c) Discuss the causes of such conditions in any given economy.
d) What policies has the Rwandan government taken to solve such conditions above?

Figure 9: Economic underdevelopment

A (housing)

B (muddy road)

C (digging)

D (children)

Facts

8.4.1 Meaning of economic underdevelopment

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

Alternatively, economic underdevelopment is an economic situation where there are persistently low incomes/resource levels or limited resource exploitation so as to satisfy nationals' welfare to desirable levels.

Most third world countries are underdeveloped or least developed, and because they are persistently struggling to develop, they are referred to as developing countries. When defining the concept of under development, the following should be noted:

1. Underdevelopment describes low level of resource exploitation and utilisation, lack of up-to-date techniques and factor imbalance.
2. The term underdevelopment is relative, meaning, we compare developed countries and less developed countries.

3. In underdeveloped countries, economic development is either possible, in the process or incomplete.
4. Some scholars have interpreted the term underdevelopment to mean the process in which less developed countries are continuously losing resources to the developed countries through unequal exchange.
5. Underdeveloped countries are at times called developing, backward, low income or third world countries.

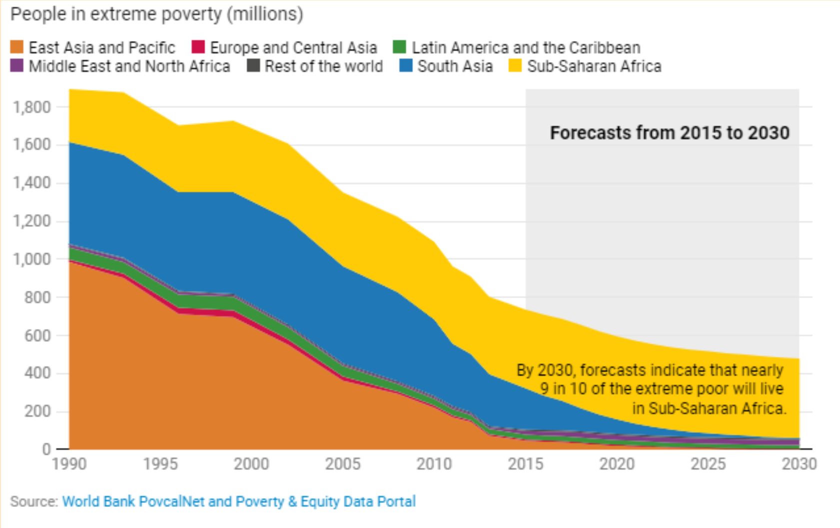
8.4.2 Indicators/characteristics of underdevelopment

- Dualism: There is existence of two contrasting sectors one being developed while the other poor e.g. rich and poor, commercial agriculture and subsistence, educated and uneducated etc.
- High population growth rate: People tend to produce more children due to cultural factors.
- High levels of dependence from one country to another since the country hasn't enough to cater for its citizens.
- Predominance of agriculture and most of the food is for home consumption. This is because the economies have little capital to invest in other sectors like industry.
- Weak and underdeveloped infrastructure: The roads especially are of poor quality and mainly small feeder roads.
- Predominance of a large subsistence sector: This is brought by the small market in the country and worse still the quality is low.
- Low levels of productivity: This is brought by poor technology that is rampant.
- High levels of illiteracy and low quality education: There are few schools and worse still the available ones are of poor quality.
- High levels of poverty among the people: This is brought about by the high unemployment rates and still lack of capital to start up business.
- Production is at excess capacity i.e. produce less than what is needed by the people because of the poor techniques.
- Political immaturity leading to instabilities are a common characteristic because of the constant struggle for power.

8.4.3 Causes of underdevelopment

Activity 11

Figure 9: World poverty levels.



Homelessness, poor health, hunger etc. are all severe poverty's consequences. These are frequently long-term consequences that lead to families that are persistently poor across generations. Unemployment is an important cause and effect of poverty, as poverty rates nearly triple among families, unemployed also more than triples. And poverty imposes huge costs on society through lost productivity and higher spending on health care and incarceration.

Using the above graph and extract, undertake research about poverty and, in class discussion;

a) Explain what you understand by the term poverty.
b) identify the indicators of poverty to an individual or economy
c) Describe the different types of poverty.
d) Account for the high levels of poverty in sub-Saharan Africa.
e) Suppose you are among the policy makers in your country, express how you would address the issue of poverty in your country..

Facts

Underdevelopment can be caused by factors which may come from within or outside the country as discussed below:

Internal causes

- High population growth rate: This increases expenditure beyond income making the country borrow to sustain its masses. This increases the indebtedness of the country, reduces savings and investments.
- Inadequate strategic raw materials and industrial inputs like coal, gold which stimulate production, industrial growth and production. This hinders industrialisation.
- Social cultural barriers such as backward rigid traditional attitudes, beliefs, and norms which hinder economic development.
- Political unrests: These hinder production, scare away investors and destroy the already set capital assets for capital accumulation.
- Underdeveloped infrastructure: The underdeveloped infrastructure such as road network and the telecommunication lines tend to hinder production and distribution of output.
- Low levels of science, technology, and research: This lowers the quality of output produced, limiting its marketability.
- The vicious cycle of poverty: People in developing countries have low income levels, consequently, they save less, invest less, produce less goods and services back to getting low incomes out of their sales.

External causes

- Profit repatriation: Several of the investments in developing countries are owned by foreigners, these take back the benefits ploughed out of these investments back to their home countries leaving developing countries in a worse state than they were before.
- The debt servicing burden: Developing countries contract loans to set up investments for development, all benefits obtained flow back to the lenders in servicing these debts and paying them back rather than re-investing them.
- High levels of brain drain: Several of the educated and high skilled personnel in developing countries go abroad for greener pastures. This leaves LDCs with the weak, dull, lazy and the unskilled labour force that cannot aid further development.

- The unfavourable trade position: Several LDCs produce and export primary products which are semi processed or not processed at all, consequently they fetch less revenue because of their low value.
- Neo colonialism: Several developing countries, though claim to be independent still follow the principles, practices and policies of their former colonial masters which can no longer develop them, they continue to get loans from former colonialists, increasing their indebtedness.

8.4.4 Policies that can be undertaken by Rwanda to solve the problem of underdevelopment

Rwandan government can use the policies discussed below to solve the problem of underdevelopment and take the country to the next level:

- Education reforms: This is to help many people to access education so that they can be prepared to get jobs and save the people from poverty. This has been done by the government and more is still being done to change the way studies are being carried out. A typical example is the new competence based curriculum that adds many aspects to the teaching learning process.
- Improving infrastructure like roads which helps in the movement of people and goods from areas of production to markets. It also helps people to increase their income. This is being carried out in different parts of the country.
- Liberalisation of the economy: This helps people to participate in different economic activities and trade hence increasing their income and standards of living. The introduction of many businesses in the country has been partly because of the government carrying out liberalisation.
- Controlling population growth: This can and has helped to reduce the ratio of resources to the population and also dependence burden among the families. The families are able to have an increased disposable income that they can use to start up small businesses necessary to increase their incomes and reduce poverty levels.

- Modernising agriculture. This can and has helped to reduce the level of poverty in rural areas where the activity is fully based. People are able to increase the quality and quantity of their products hence receiving more incomes. Modernisation further increases the people in the sector since it can no longer consume more time since machines used save time.
- Land tenure reforms: This is through land redistribution policies, land reclamation, consolidation among others and making it accessible to all people in society so that they can be able to carry out agriculture. This will help to reduce unemployment.
- Kick start funds like the one cow per family: This is done to help the very poor who don't have a starting point. Through the cow the owner is able to get access to milk that can bring in little income and also improve his deity.
- Progressive taxation: This reduces the gap between the rich and the poor since the revenues collected are used to subsidise the poor and further infrastructure development.
- Improvement of the investment climate: This has been through giving tax holidays and free land like the free investment zone in Masoro. The government can create more land available to the investors to set up industries so as to create more employment on top of what has been created by those existing.
- Improvement of the political climate: This has previously created good environment for production where by people are not scared of carrying out any activity. The government can continue to strengthen its security across all borders so that external forces from neighbouring countries cannot get easy entry into the country to destabilise peace.
- Encouraging development of small scale enterprises: These can create more employment opportunities in the country because they are easy to start and do not need a lot of capital and technology to start. Still the labour they use is not so complicated as that of large scale enterprises.
- Formation of co-operatives: This has been the basis for reducing income inequalities among people. These such as Sacco's like Umurenge Sacco, Umwarimu Sacco, producer co-operatives among others have encouraged micro savings and given small loans to local people.

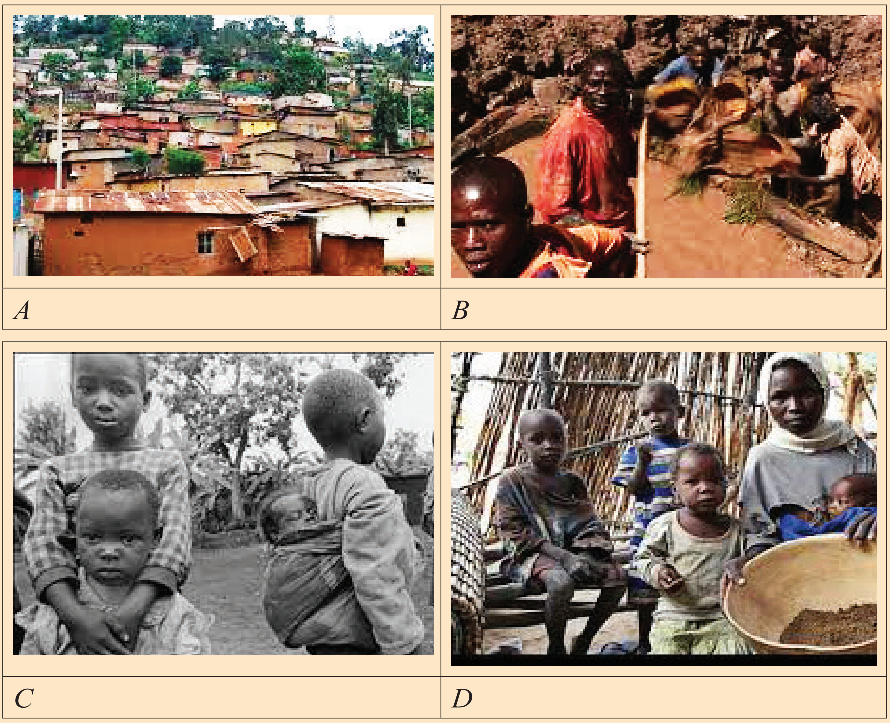
8.5 Poverty

Activity 12

Basing on the photos A, B, C and D in figure 10 of this unit, discuss the following questions.

1. What do the photos show?
2. …… is the situation where a person fails to get the basic needs of life.
3. The following are characteristics of such situation except
   (a) Low standards of living
   (b) Absence of basic needs
   (c) Low self esteem
   (d) Good medical care

Figure 10: Faces of poverty



A *B* *C* *D*

Facts

8.5.1 Meaning of poverty

The term 'poverty' has diverse meanings. According to the World Bank, it means the inability to attain a minimal standard of living. To the United Nations, it implies the denial of choices and opportunities most basic to human development, reflected in a short life, lack of basic education, lack of material means, exclusion, and a lack of freedom and dignity. Other economists have also defined it as;

A situation where the individual's income is low or where individuals in the society have insufficient income to buy basic necessities to maintain their livelihoods.

Poverty: is hunger; lack of shelter; being sick and not being able to see a doctor; not being able to go to school and not knowing how to read; not having a job, fear for the future, living one day at a time; losing a child to illness brought about by unclean water; powerlessness, and lack of representation and freedom.

8.5.2 Types of poverty

- **Situational poverty:** this is poverty that is generally caused by a sudden crisis or loss and is often temporary. Events causing situational poverty include environmental disasters, divorce, or severe health problems.
- **Generational poverty:** This is poverty that occurs in families where at least two generations have been born into poverty. Families living in this type of poverty are not equipped with the tools to move out of their situations.
- **Absolute poverty (destitution):** this refers to the situation which involves a scarcity of such necessities as shelter, running water, and food. Families who live in absolute poverty tend to focus on day-to-day survival. Absolute is used here to indicate a fixed and minimum set of basic resources which all individuals are said to require in order to physically sustain life. Absolute poverty refers to income level below that necessary to meet basic needs.
- **Relative poverty** refers to the economic status of a family or individual whose income is insufficient to meet its/ their society's average

standard of living. It occurs when people in a country do not enjoy a certain minimum level of living standards as compared to the rest of the population and so would vary from country to country, sometimes within the same country.

- **Urban poverty:** this occurs in metropolitan areas with populations of at least 50,000 people. The urban poor deal with a complex aggregate of chronic and acute stressors (including crowding, violence, and noise) and are dependent on often-inadequate large-city services.
- **Rural poverty:** this occurs in nonmetropolitan areas with populations below 50,000. In this case, such areas are characterized by households and families which often have less access to services, support for disabilities, and quality education opportunities.

8.5.3 Characteristics of poverty

- Low standards of living since the people cannot afford the basic needs in life.
- Absence of basic needs that are needed for good welfare. These may include food, clothes, shelter and water among others..
- Low self esteem as the poor don't see themselves as important people in society .
- Poor living conditions are common amongst the poor. They don't have meals, and other basic necessities.
- Consumption of inferior commodities that may be of poor quality. This is because they cannot afford the good quality.
- Low levels of savings because they have no jobs and sources of income.
- Constant family conflicts and break ups brought about by failure to sustain homes and children.
- High rates of school drop outs due to lack of income to buy the necessities at school as well as paying the school dues.

8.5.4 Poverty trends and dynamics in Rwanda

Poverty in Rwanda, as measured by the international poverty line, fell from 77.2% in 2001 to 55.5% in 2017, while poverty measured by the national poverty line declined from 58.9% to 38.2%. The poverty reduction rate has slowed in Rwanda, with 14.5% moving out of poverty between 2010/11 and 2013/14 and 9.52% moving in, compared with 13.4% moving out of poverty between 2013/14 and 2016/17 and 11.7% moving in.

Rwanda is a poor country with a gross domestic product (GDP) per capita of US$748 in 2017 according to the World Bank, where 80% of the population are rural, 85% of the poorest quintile are dependent on agriculture and there are wide regional variations in poverty exit rates, with higher proportions of poor people in the Southern Province (and, to a lesser extent, in the Western Province) than in either the Northern or Eastern Provinces (World Bank, 2017). The capital Kigali is different from the rest of the country, with asset measures of poverty showing only 1% of the city's population categorised as 'poorest', compared to 32% in the Southern Province. Similarly, 64% of the population of Kigali is in the wealthiest category, compared to only 11% in either the Southern or Northern Provinces. There have also been regional differences in poverty reduction rates, with much of the poverty reduction occurring in Kigali while the poverty headcount has risen in the Western Province and extreme poverty has risen in the Southern Province.

Facts

The causes of poverty are discussed below:

- High cost of education: The high cost of education has resulted into poverty. High school fees are a huge burden to households. Many are unable to afford the high cost of education and hence forcing children out of school. This consequently limits their accessibility to employment opportunities.
- Large family size: The size of the family has a direct bearing on poverty. Total resources which are available to a family decrease with an increasing size of the family.
- Lack of physical assets: Land is the most important physical asset for the poor. Both the size of the land and its quality play an important role in determining poverty. A number of poor people in Rwanda do not have land. Although the causes of landlessness differ from society to society, the most common causes are high population growth, poor land tenure system and overgrazing.

- Epidemics and pandemics: These have affected most households in Rwanda. The young and productive have especially been affected which has brought about the rise of child headed families and families headed by the aged who may no longer have the energy to do some economic activities. Treatment of these diseases is very expensive, causing a great financial burden on the family.
- Low agricultural productivity and poor marketing: Factors such as prevalence of traditional farming methods, low soil fertility, unpredictable weather conditions, poor and inadequate extension services, high cost of inputs, low quality seeds, lack of credit facilities, lack of water and pasture, animal diseases, poor livestock health and lack of information on marketing have contributed to poverty in Rwanda. There are food shortages, underemployment and negligible incomes which are almost entirely for meeting the basic needs.
- High cost of social services: Lack of drugs, absence of health personnel, increased cost of drugs, long physical distance and collapse of maternal and child health services are some of the factors which have contributed to poverty. The poor do not have satisfactory access to health facilities.
- Markets and macro-economic instability: Limited physical access to markets, cost of transportation, exploitation by traders and lack of rural markets are some of the factors that have led to poverty in Rwanda.
- Disability: People with disabilities are socially marginalised and neglected in some parts of the country. They are disadvantaged from opportunities.
- Unemployment and low wages: Unemployment and low wages both in urban and rural areas have caused poverty in Rwanda. Individuals are unable to purchase certain goods and services.
- Land scarcity and the legal protection of property rights: In rural areas, people's ability to accumulate asset, and generate income depends on the wealth of the individuals and on the institutions operating in the society. The system for land titles inheritance and ownership, unequal distribution of land and increasing scarcity of land are some of the factors that have caused poverty.

- Environmental change: This is yet another cause of poverty in Rwanda. The environmental change is due to overstocking of grazing lands; deforestation and associated climatic change partly caused by charcoal burning; wetland degradation and associated reduction in water quantity and quality; soil erosion resulting in landslides, water pollution and; depletion of wetlands.
- Population growth: Poverty in Rwanda is partly explained by the high population growth rate. Shortage of land and environmental degradation are accelerated by population growth.

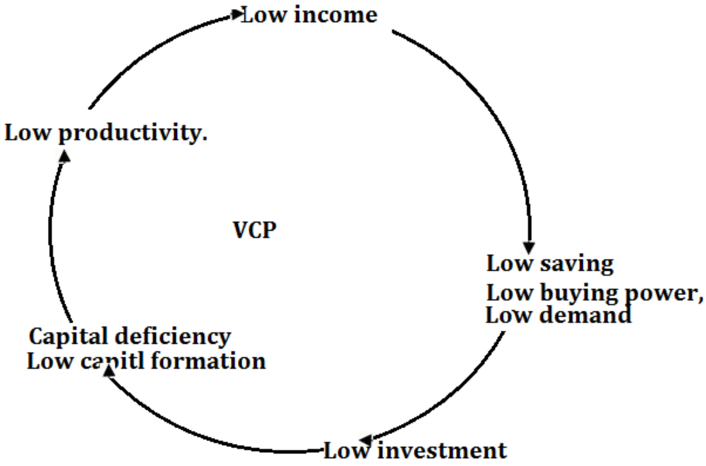
8.5.5 Ways of reducing poverty

Poverty should be reduced using the ways discussed below:

- Avail credit facilities to the people which will help them to start their own businesses.
- Development of infrastructure aimed at opening up rural areas to investment and also easy movement of goods from remote areas to markets.
- Create political stability so as to boost production and employment.
- Progressive taxation of the rich so as to reduce income inequalities and subsidise the poor.
- Increase wages and set fix a higher minimum wage so as to increase people's income, hence raising their demand.
- Subsidising the poor by giving them unemployment benefits like free education, food tickets, etc.
- Seek foreign aid to expand local production and investment so as to provide employment.
- Encouraging investment through giving incentives like tax holidays to investors.
- Increasing prices for agricultural products so as to boost production in the agricultural sector.
- Supporting the formation of cooperatives and encouraging people to join them making it easy for them to access support from government and NGOs.

8.5.6 Vicious cycle of poverty

Figure 12: Poverty cycle



Vicious cycle of poverty is a concept that illustrates how poverty causes poverty and traps people in poverty unless an external intervention is applied to break the cycle.

It simply means poverty begets poverty.

It is hard to determine where the cycle begins because each stage leads to another and through circulating they keep repeating.

When people have low incomes, they end up consuming most of it and end up saving little or none. Due to the low savings, people may not be able to invest in anything and this further means that productivity will become low. Due to the low productivity, people have little or nothing to sale and this implies that they will get low incomes and the cycle will continue.

At the national level, GDP may be low which leads to low national savings implying` low aggregate investments, low output and finally low gross domestic income.

The vicious cycle of poverty can be broken by:

- Increasing savings so as to accumulate capital needed for increase in production.
- Increased use of resource to create employment opportunities, increase production and earn incomes necessary for acquiring basic needs.
- Technological advancement to promote production of goods for sell so as to get earnings.
- Increased infrastructure development by the government to help in the movement of goods and services from production areas to markets.
- Creation of more employment opportunities through formation of co-operatives so as to pull resources together.
- Controlling population growth to reduce dependence, thus increasing savings and capital accumulation.

Unit assessment

1. Examine the factors that influence Rwanda's productivity in goods and services.
2. (i) Growth may either be through using balanced or unbalanced strategies. Explain reasons why Rwanda opted for the unbalanced strategy rather than the balanced strategy.

   (ii) What would be the advantages of balanced development for Rwanda's economy?
3. Discuss the extent to which economic dependence has been more of a blessing than a curse to the economy of Rwanda.
4. "Rwanda's movement from one level to another in terms of development has faced many obstacles during the course." Support this statement.

Glossary

- **Absolute poverty**: A situation where people are so poor that they cannot even afford the basic means of subsistence like food, shelter, clothing, sanitation, education, etc.
- **Balanced growth**: A strategy of economic growth which advocates for a simultaneous upbringing of all sectors in an economy so that sectors grow together in harmony and complement each other.
- **Big push theory**: The theory states that, "developing countries must massively invest in a variety of industries and economic infrastructure so as to transform a backward agricultural economy into a self sustained dynamic economy."
- **Critical minimum effort**: A minimum level of investment in all the sectors of the economy to ensure interdependence and self sustaining growth.
- **Economic growth**: A quantitative increase in the volume of goods and services. Or the persistent increase in the volume of goods and services over a period of time.
- **Economic dependence**: Reliance of an economy on another for resources and economic decisions.
- **Economic development**: Sustained quantitative and qualitative increase in the volume of goods and services produces over a period.
- **Economic underdevelopment**: An economic situation where a society has resources but has failed to put them to maximum use or maximum exploitation so as to improve the welfare of individuals.
- **Poverty**: A situation where the individual's income is low or where individuals in the society have insufficient income to buy basic necessities to maintain their livelihoods.

- **Relative poverty**: A situation where people's living standard is below what is regarded as socially acceptable (minimum).
- **Unbalanced growth theory**: This theory emphasises the growth of a few vital leading sectors in an economy such that they expand and others are developed at a later stage.
- **Vicious cycle of poverty**: A trend that shows how the people and the economy have been trapped in a cycle from which they cannot easily come out.

Unit summary

- Economic growth
  - Meaning
  - Determining factors
  - Costs and benefits
- Theories of growth based on sector balancing
  - Balanced growth theory
  - Unbalanced growth theory
  - Big push theory
- Theories based on causes of growth
  - Rostow's stages of growth
  - Dependence theory
  - Marxist theory
- Economic development
  - Meaning and indicators
  - Comparison between economic growth and development
- Under development
  - Meaning and characteristics
  - Causes and policy measures
  - Poverty

Topic Area 5: Development Economics

Sub-Topic Area 5.2: Development Process and Strategies

UNIT 9

Agricultural Development

Key unit competence: Learners will be able to analyse the contribution of development strategies on the economy.

My goals

By the end of this unit, I will be able to:

- Explain the meaning, advantages and disadvantages of agriculture development.
- Examine the benefits and criticisms of the transformation and modernisation approaches.
- Analyse the benefits and criticisms of small scale and large scale agriculture.
- Examine the benefits and criticisms of agriculture specialisation and diversification.
- Compare the benefits and criticisms of intensive and extensive techniques.
- Explain the benefits, disadvantages and limitations of agriculture mechanisation.
- Explain the benefits, disadvantages and limitations of commercial agriculture.
- Analyse the roles and problems of agriculture cooperatives and research and extension services.
- Describe forms of land ownership and reforms in Rwanda.

9.1 Development Process and Strategies

Activity 1

Case study 1

Rwanda has experienced a number of socio-economic challenges since the colonial time. This has necessitated a multi-disciplinary approach where changes to drive the country's development agenda are realised. Development modes have helped to drive the country to where it is now. Development is not a one-day activity as the saying that "Rome was not built in one day", Rwanda also has had to move through different processes and stages to its current position. Thus, for a country to be called a developed nation, the standards of living of the people and the goods produced have to be better than the former, and the environment has to be protected to preserve some resources for future use. Choosing the best possible options to achieve its objectives is a fundamental task. Rwanda has had to choose among different strategies to achieve its goals. Having a better strategy necessitates putting into consideration factors for it to be effective and guiding the country's development. The level of development in Rwanda is a clear indication of how appropriate the country's strategy is and hence more is expected as far as its vision is concerned.

From the case study above, answer the following questions:

(i) Explain the meaning of the following terms;
   (a) Development process
   (b) Development strategy.

(ii) Examine the goals that compelled Rwanda to choose the strategy it is using.

Facts

9.1.1 Meaning

Development process is a system of defined steps and tasks such as strategy and organisation that are used to convert ideas into commercially viable goods and services.

Development strategy is a set of guidelines which a country should follow in formulating and implementing long term policies meant for development. The major development strategies for LDCs include agricultural development, industrial development, education etc.

9.1.2 Goals of development strategies

Most of the countries set up objectives to eradicate problems that they face so as to have a better welfare in the country. Below are some of the objectives for developing countries:

- Achieving fair income distribution.
- Reducing poverty among the people.
- Attaining favourable balance of payment position.
- Reducing unemployment rates.
- Reducing the rates of dependence.
- Controlling population growth rates.
- Improving health services.

9.2 Agriculture Development Strategy

Activity 2

1. Using photos, A, B, C and D in Figure1, discuss the following questions:
    (i) Which activities are taking place in the photos?
    (ii) Analyse the difference between the activities carried out in the last two photos C and D.

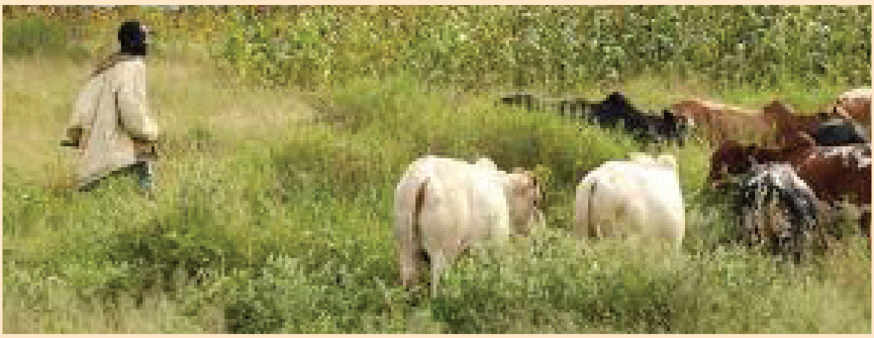
(iii) Explain the meaning of agricultural development.

(iv) Explain the advantages and disadvantages of agricultural development.

Figure 1: Agriculture modernisation

A

B



C

D

Facts

9.2.1 Meaning

Agriculture is the growing of crops and rearing of animals. There are both food crops and cash crops involved together with a variety of animals. Agriculture is basically the backbone of developing countries contributing wholesomely to their economies and thus its development is paramount.

Agriculture development therefore is the process of promoting proper conditions for farming so that the quantity and quality improve drastically. It can also be looked at in the perspective of providing assistance to crop producers with various agricultural resources for better output attainment. The major objective is to get good standard output that will enable the country gain more output while at the same time protecting the environment.

Characteristics of agriculture in LDCs

- Agriculture is mainly done on a small scale where most of what is grown is for home consumption.
- Mainly, the large-scale agriculture farms are owned by foreign companies that repatriate profits and this leads to capital outflow.
- The small-scale farms use basically labour-intensive techniques of production leading to low output.
- The output produced is basically of low quality compared to that of the developed countries hence leading to low income from exports.
- Normally specialisation is carried out by only the large-scale farms.
- Small scale farmers normally use simple tools and family labour when carrying out their activities.
- Food crops are the major crops grown by most agriculturalists since they are for home consumption.
- Large areas are covered by the large-scale farms leading to less land for settlement.

9.2.2 Arguments in favour of agriculture development

Below are the arguments in favour of agriculture development:

- It provides enough food necessary to feed the population and this reduces diseases related to food scarcity like malnutrition.

- It provides employment to people which enables them earn income and improve their standards of living.
- It provides raw materials to industries which increases the rate of industrialisation and employment.
- It leads to increased output for export which in turn earns the country foreign exchange used for development.
- It is a source of medicine for the population especially the herbs used in traditional treatment which can also be turned into the modern commonly used medicines.
- It provides backward linkages to the industrial sector where it acts as market for the industrial output such as the hoes, pangas etc.
- It reduces rural urban migration because people are employed in the agriculture sector which is normally carried out in rural areas.
- It facilitates development of infrastructure like roads because of the need to transport commodities from rural areas to the market.
- Agriculture development leads to fair distribution of income because it provides employment.

9.2.3 Disadvantages of agriculture development

Agriculture development has numerous disadvantages as discussed below:

- Agriculture prices keep on fluctuating consistently due to the differences between planned output and actual output these coupled with poor climate conditions affect the supply and production.
- Agriculture development may involve expansion of the firms among others and this may affect the growing population in terms of settlements leading to fragmentations.
- Products are perishable and difficult to store. This is a big problem that affects developing countries and worse still they are bulk and may not be transported easily to other parts of the country.
- Some crops have a long gestation period and thus the farmer may take long to gain from them even if the prices increase at present, the farmer may not increase supply thus losing out.

- Agriculture mostly depends on nature. Farmers may fail to increase supply in case of a fall in rainfall. The inconsistencies in climate worsen the problem of price fluctuation.
- Most developing countries produce the same goods thus products flood the world market causing prices to fall.
- Development of synthetic fibres deemed the demand for agricultural products low due to presence of their substitutes. Hence they cannot bring in a lot of revenue.
- The high rates of conservatism among the African farmers has led to the desire to have quantity rather than quality leading to low revenue.

Limitations of agriculture development in Rwanda

Below are the challenges of agriculture development in Rwanda:

- Weak extension and research services: There is generally lack of extension services in the country to transmit research findings about better production methods and ways of living to farmers in order to improve agricultural productivity. This has led to poor use of fertilisers and agricultural chemicals that have polluted water; and agricultural activities and general mismanagement of the wetlands which have further degraded and destroyed them.
- Land shortages: High population density has fuelled a shortage of arable land, led to decreasing farm size, shortage of arable land and the adoption of intensive agricultural practices on land with no fallow and declining soil fertility. As a result of land shortages, even the most fragile areas are not spared. For instance, the ecologically sensitive areas of Ruhengeri, Gisenyi have the highest population densities. This has increased pressure on the ecosystems resulting in the current degraded state (loss of biodiversity; over-cultivation; soil erosion; declining productivity) and more poverty.
- Overgrazing and bush fires: These have been the greatest culprit for reduction of biodiversity as they result in the extermination of the most grazed species as well as pyrophlitic (fire-resistant) species with low bromalytic (nutritive) such as Erogrostics, Sporobolus and Digitalia.

- Poor and rugged land terrain: Agriculture practiced on the slopes of hills and mountains, coupled with deforestation has caused extensive land degradation and soil erosion. About 40 per cent of Rwanda's land is classified by the FAO as having a very high erosion risk with about 37 per cent requiring soil retention measures before cultivation. Only 23.4 per cent of the country's lands are not prone to erosion (ROR 2008). This has rendered agricultural productivity inefficient thus hampering agriculture development.
- Risks and uncertainties: Increased vulnerability to climatic shocks like drought or heavy rains. Unpredictable risks are common in this sector, for example, a drought that hit the country in 2016, mainly the Eastern Province. Almost the entire country felt the effects of the longest drought in the last 60 years. But, the Eastern Province was hit the most. More than 47,300 households in Eastern Province bore the blunt of such drought which also caused crops to wither, resulting in crop failure and threatening food security. The situation necessitated government intervention in terms of food distribution to the affected families that had no harvest for two seasons since September 2015.
- Lack of information on agriculture investment prospects: One of the main challenges to increased private investments in Rwanda is the lack of quick and accessible information on land available for commercial use by potential interested private investors.

Ways of improving agriculture productivity in Rwanda:

Agriculture is recognised in the EDPRS as one of the priority sectors that will both stimulate economic expansion and make the greatest contribution to poverty reduction and food security. However, as demonstrated in the problems above, a number of factors are threatening these efforts. The government has put in place a number of strategies to address these threats as discussed bellow:

- Improvement in the breeds of animals and crops: The One Cow per Family (Gira Inka) programme has been effective in promoting improved cow breeds among Rwandans not only to improve nutrition and income through milk production and sales, but also to provide organic manure to improve crop production. This system has been extended to other animals such as goats, which are expected to significantly reduce overgrazing and related environmental degradation problems.
- Subsidisation to farmers: The government of Rwanda has taken a policy decision to subsidise fertilisers and improve its distribution through the use of private sector. For example, in 2016, around 32,000 tonnes of mineral fertilisers were used, according to RAB, and the government targets to have about 50,000 tonnes of mineral fertilisers applied in the 2017 agriculture season A and B, with estimated Rwf9 billion in subsidies for both seeds and crops in the same period. This will help increase the use of mineral and organic fertilisers, pesticides and selected seeds as well, help to reduce soil nutrient loss. However, since the misuse of agro-chemical products have harmful consequences on human and ecosystem health, the policy has to be accompanied with training on the control and management of the negative impact of agro-chemicals.
- Soil erosion and nutrient loss control: The government of Rwanda is aggressively pursuing measures for soil erosion control. These measures include terracing, increasing soil cover and integrated management approaches such as agro-forestry and zero-grazing. There have been increases in the area under radical terracing. However, small scale farmers lack the capacity to respond to the control of soil erosion because the anti-erosion measures are expensive.
- There is potential for arable land expansion through the use of irrigation: The EDPRS aims to increase the area of hillside agricultural land under irrigation from a baseline of 130 ha in 2006 to 1,101 ha in the year 2012. This has implications for environmental management and thus creates urgent need to develop technical expertise within the agriculture and environment sectors to ensure that Strategic Environmental Assessments (SEA) and Environmental Impact Assessments (EIA) are incorporated into the crop intensification programme to guarantee that adequate soil and water management measures are undertaken.

- Strengthening extension services and extension-research linkages tailored to solving the farmers' problems. The on-going review of agricultural organisations with the objective of decentralisation, offers the opportunity to improve management, effectiveness and to bring extension and research to the farm level. The Agricultural Sector Wide Approach (SWAP) encourages a more integrated approach to the sectoral programmes.
- Improving population control and farming methods: The current population control methods continue to have inadequate impact and population pressure on land continues. There is also little concerted effort to create off farm employment. The current EDPRS flagships focus on improving policy on privatisation and job creation which is likely to enhance off-farm options with overall benefits for environmental management.
- Construction of valley dams: To mitigate the drought impact and ensure preparedness and resilience against climate change effects, the ministry of agriculture, encouraged construction of valley dams, whereby six have already been built in Nyagatare district, six in Kayonza district and one in Gatsibo district. Each dam has capacity of 40,000 cubic metres (m3) of water for cattle.
- The cultivation of drought resistant forage for livestock's consumption, and irrigation: An estimated 19,000 hectares of land are expected to be irrigated from 2016 through 2018, which include 15,000 hectares for marshland and 4,000 for hillside, according to Rwanda Agriculture Board (RAB). About 45,000 hectares are already under irrigation in the country.
- Seeking foreign aid to support agriculture: For example, on November 4, 2016, the International Fund for Agricultural Development (IFAD) and the government of Rwanda signed an agreement for Rwanda Dairy Development project, a new initiative that is expected to improve the livelihoods of over 100,000 smallholder farmers and generate opportunities for other actors in the country's dairy sector. The new project aims at having improved milk quantity and quality, farmers' processing capacity through promotion of climate smart technologies and practices, and support the development of dairy cooperatives to benefit from market driven production, processing and trading of improved dairy products.

- Lease of Kigali Urban Fisheries Centre: The government leased management and operationalisation of Urban Fisheries Products Promotion Centre, located in the Kigali Special Economic Zone by AQUAHORT Export Ltd/AEL, a move that is intended to ensure proper handling of fish produce, market access and, most importantly, address the issue of lack of enough nutritious fish feeds, which has been a major concern for the sector. This will help fish farmers benefit from on-credit feed from the factory set up by the company through an agreement requiring farmers to supply it with fish.
- Setting up of an institution that helps in agricultural practices: The government of Rwanda merged the three institutions namely; the Rwanda Agricultural Research Institute (ISAR), Rural Agricultural Development Authority (RADA), and Rwanda Animal Resources Development Authority (RARDA) into one body i.e. Rwanda Agriculture Board (RAB). This institution helps in ensuring that farmers properly use arable land available in the country to get optimal produce, empowers farmers in terms of good farming practices and provides them with quality improved seeds; and also ensures effective implementation of research and extension services such that new agricultural inputs reach farmers and benefit them accordingly.
- Extending friendship to other agricultural based countries: For example, on October 20, 2016, Rwanda and the Kingdom of Morocco signed bilateral agreements in the advancement of agriculture sector which will see sealed cooperation of the two countries' agriculture ministries in areas including exchange of expertise in water management, agriculture finance and crop insurance, horticulture, animal health and production, soil mapping and testing, irrigation as well as fertiliser manufacturing and blending. Basing on their bilateral agreement, Office Chérifien des Phosphates (OCP) – a Moroccan state-owned phosphate mining company which is the world's leading producer of phosphate rock and phosphoric acid as well as one of the leading global fertiliser players — to set up a fertiliser blending factory in Rwanda. This will give farmers access to better agricultural input products that are tailor-made for the local soil, hence improving agricultural productivity.

- Putting up a monitoring and assessment committee to evaluate performance of agriculture and livestock sector: Members of the Senatorial Standing Committee on Economic Development and Finance are meant to engage in outreach tours that are intended to monitor and assess the performance of the agriculture sector in the country. The assessment is based on the benchmarks outlined in government's current seven year programme, running from 2010 through 2017, aiming at stimulating the country's development in various aspects, including governance, justice, economy and social well-being.

  The committee in their tours, have to evaluate the progress of the programme and make recommendations necessary. e.g. In 2016 the committee emphasised that there should be research on crop diseases such as in cassava, banana, fruit and beans and ensure that there is enough and affordable improved seeds so as to meet agricultural targets.
- Launching of Agriculture Land Information System (ALIS): On October 11, 2016, the Government of Rwanda launched the first phase of Agriculture Land Information System (ALIS) to help fast-track the government's goal of transforming agriculture from subsistence to an economic engine. This will help investors from anywhere in the world to have easy access to land information, including size, general soil type, suitability to a given crop, current land use, electricity, proximity to roads and water sources, and agro-climatic conditions.
- Revision of the agriculture policy by MINAGRI: The agriculture policy that was developed in 2004 was revised in 2016 with intention to optimise produce from agriculture and livestock sector, at the same time ensuring proper utilisation of natural resources and sustainability for future generations. It also aimed at ensuring that farmers get affordable seeds and access to markets for good prices and income, development of crop and livestock varieties resistant to climate change related issues, and agriculture and livestock insurance as well as the use of ICT in agriculture.

- Value-addition to agricultural produce: This is through setting up agro-processing units, and enabling proper post-harvest handling to avoid losses. This helps to intensify and commercialise agriculture, increase agricultural growth and export sector as well; this will contribute toward the country's middle-income status goal with per capita GDP of $1240 by 2020.

9.3 Approaches to Agriculture Development

An approach is a method or plan chosen to bring about a desired future, such as achievement of a goal or solution to a problem. Agriculture development involves making agriculture desirable and profitable to all stake holders in the country, promoting proper conditions for farming so that the quantity and quality improve drastically for better standards. The development of agriculture has been done by the different agricultural cooperatives such as KEHMU (Koperative Ejoheza Muhinzi w'Umuceri), KOIMUNYA (Koperative Imbazabigwi Muhinzi w'Umuceri Nyakabuye), Copro-Mabya in the north dealing with passion fruits, COTHENYA dealing with tea in Nyaruguru. These have played a very big part in developing the nature of agriculture in which the deal in conjunction with the government.

The development of agriculture involves two approaches i.e. the modernisation and transformation approaches.

9.3.1 Transformation approach

Activity 3

Study the set of photos A and B, in figure 2 below and undertake research on approaches to agriculture development, thereafter, answer through sharing in class, the questions that follow:

Figure 2: Agriculture practices.

Required:

(i) Analyze the differences between the two sets of photos.

(ii) What do you understand by the term agriculture transformation?

(iii) In which ways can a farmer transform his/her agricultural practices?

(iv) Why may you not support the transformation approach to agriculture development?

Facts

Meaning

Transformation approach involves a complete and total change in the existing agricultural sector practices and systems. It includes changing from traditional low yielding systems to high yielding systems. The objectives of this approach are the introduction of technical, social and legal systems, which allow for the exercise of modern agricultural techniques based on high productivity. The approach may involve the following:

- Adopting large scale mechanised agriculture especially the use of modern equipment and putting in place large storage facilities.
- Commercialised agriculture where most of what is produced is for market consumption and little is left for home consumption.
- Change of culture and beliefs from conservatism to modernity, eg. from rearing local breeds of cattle to exotic Frisian breeds.
- Movement of people from one area to another to create land for large scale agriculture.
- Development of social infrastructure like roads and communication net work to ease movement of goods and people.
- Comprehensive land reforms like changing the system of land ownership.

Benefits of transformation approach

The benefits of the transformation approach are discussed below:

- Encourages mechanisation: The approach involves large scale agriculture that requires large land required to increases output.
- Industrialisation: Due to the increase in the output, they may develop agro-based industries to improve the quality that increases the revenue.
- Culture of the farmers is changed and this can enable to begin considering quality instead of the large quantity.
- Employment: This comes as a result of the large fields that are developed due to mechanisation.
- Production costs are reduced when the firms expand and enjoy the economies of scale and this helps to have increase in savings.
- The large farms can be able to provide extension services to the local people. These could be study tours and practical lessons to the people.

Disadvantages of the transformation approach

Despite the benefits the transformation approach has the following disadvantages:

- It may result into technological unemployment due to the high use of machines.
- It may lead to erosion of domestic cultural values due to the complete change in the agricultural set up.

- It may lead to Rural Urban Migration due to use of machines and thus rendering people in villages unemployed.
- Large-scale production may lead to displacement of people thus affecting their living standards.
- Since the approach requires complete change in the system, it might lead to resistance from farmers thus leading political instability and social insecurity.
- It may lead to dualism where some sectors are more developed than the other or some part of agriculture which is transformed advances at the expense of the part that is not transformed.
- Due to large scale production and use of machines, it may lead to over exploitation and quick exhaustion of resources.
- Specialisation is associated with massive production thus leading to surpluses and wastage due to a small market in LDCs.

Criticisms of the approach

Below are the criticisms of the transformation approach:

- Unemployment may come up because with development and need to produce more, farms may resort to capital intensive techniques of production.
- There is need for resources to train the people about the new systems and worse still purchasing the required equipment seems costly.
- Some cultures are too conservative and unwilling to change; take an example of the Masai in Kenya and the karamajong of northern Uganda.
- Inadequate entrepreneurship skills to carry out the innovations and inventions still lacks in the developing countries.
- The relief of the land is a problem that may not encourage mechanisation. In the areas of Musanze, the hills are many and steep so the approach may not take off.

9.3.2 Modernisation approach

Activity 4

Basing on the photos A and B in figure 3 below, and the research carried out in activity 3 of this unit, on the approaches to agriculture development, answer, through sharing your views in class, the questions that follow;

Figure 3: People engaging in farming

	
A (using hoe)	*B (using oxen)*

Required:

(i) Analyse are the differences between the two photos A and B.

(ii) What do you think is called the approach to agriculture development is called? Support your answer.

(iii) How else, using the same approach, can a farmer practice agriculture than using the above shown way in the photo 3 B?

(iv) Analyse the benefits of using such an approach to agriculture development.

(v) Why do you think this approach is not common in Rwanda?

Facts

Meaning

Modernisation/improvement approach is the method of encouraging agriculture development that aims at improving the existing frame work to increase the quality and quantity of output. It has to operate within a given set of social relationship (beliefs, customs), existing production techniques and market opportunities. The improvement approach necessitates the improvement of the existing production techniques without changing the basic organisation of farming. It relies on agricultural extension and the provision of certain necessary inputs to farmers. The improvement approach involves the following:

- Persuading and encouraging farmers to improve on their methods of farming.
- Provision and use of simple and time saving equipment like the ox-plough.
- Extension of long term and medium term credit to farmers.
- Provision of agriculture extension services to rural farmers eg educating farmers through mass media and demonstration farms.
- Soil improvement.
- Undertaking land tenure adjustment programmes to improve on the system of land ownership.

Benefits of agriculture modernisation

The benefits of agriculture modernisation are discussed below:

- Provision of enough food necessary to feed the population hence creating a food basket and reducing food related diseases.
- Provision of employment to which enables the population to earn income and improve their standards of living.
- Provision of raw materials to industries which increases the rate of industrialisation and employment basically agro-based industries.
- It leads to increased output for export which in turn earns the country foreign exchange hence reducing B.O.P problems.
- It is a source of medicine to people of the country especially through the herbs for traditional treatment and for making modern medicines .
- It provides backward linkages to the industrial sector where it acts as market for the industrial output such as the hoes, pangas etc.
- It reduces rural urban migration because people are employed in the agriculture sector which is normally carried out in rural areas.
- It facilitates development of infrastructure like roads because of the need to transport commodities from rural areas to the market.
- It leads to fair distribution of income because of employment.

Challenges of the modernisation approach

Modernisation approach of agriculture has faced numerous limitations as discussed below:

- Poor weather conditions: Sometimes the rains fail to come and other times there are floods. This affects farmers because there are differences between planned output and actual output.
- Poor land tenure systems: Some of the land is owned by absentee land lords and hence it is inactive. The idle land has not helped in the implementation of the system.
- Narrow markets: The market is low due to poverty among the people and the low quality that cannot yield much revenues.
- Poor infrastructure: This limits the movement of goods from gardens to markets and also from areas of low prices to areas of high prices.
- Lack of skilled manpower: Most of the people have low skills and worse still they take long to adjust to the new techniques.
- Conservatism of farmers: Some farmers are very conservative and unwilling to adjust and this has affected the system.
- Inadequate capital: This is still very low and the low producers cannot access the improved equipment necessary to improve quality and quantity.

9.3.3 Small scale subsistence production

Activity 5

Case study 1

Mukamuganga is a farmer staying in Gicumbi district. She and her family of three; have a small garden around their home where they grow maize, cassava, beans, sweet potatoes and keep two goats for survival. They use hoes and pangas on their small farms. It has helped them have food for the home though the quality is very poor. In the same village, there is Mukeshimana an organised well known farmer who grows sweet potatoes on a large piece of land. She employs many workers and some times uses machines. After the harvest, she takes her output to the market for sale and earns some profits out of her sales.

Basing on the above case study, answer the following questions,

(i) Mukamuganga is a ………….. type of farmer.
(ii) Describe the characteristics of the type of farming that Mukamuganga carries out.
(iii) Explain the advantages and disadvantages of the type of farming Mukamuganga carries out.

Facts

Meaning

Small scale production is a situation where all the activities that are done in agriculture, industry, mining etc. are done on a small area. Normally it is subsistence in nature and most of what is grown is for home consumption and the incidental surplus is sold to meet the basic needs. In developing countries, Rwanda inclusive, most of the production is subsistence in nature and is basically done around homesteads in small gardens, small buildings, creating small scale industries, small mining sites among others. The output expected from these activities are normally small and intentions are basically for home use and the incidental surplus sold. Small scale subsistence production has the following characteristics:

- Low output is produced since most is for home consumption.
- Low quality is produced because simple tools are used and no modernisation is carried out.
- Production is for minimum survival to protect the family from famine.
- Family labour is used since most of the times the activities are located near homes.
- Simple tools such as hoes, pangas, chop sticks, knives are used since it is done on small scale.
- Mainly food crops like cassava, yams, maize, matooke etc are grown basically to cater for home needs.
- It's normally done on a small piece of land and in small buildings in case of industries.
- There is no specialisation carried out since a variety of crops are grown.

Merits of small scale subsistence production

Small scale production has a variety of advantage as shown below:

- Little marketing is needed since most of the food is for home consumption and only the incidental surplus is sold.
- Easy management: This is because output is small and it employs few workers during the production process.
- Little or no wastage: This is because production is done on small scale and bases on the size of the family.
- Variety is grown and kept: This helps people to have a balanced diet which saves them from problems of malnutrition.
- There is no major problem of labour since family members are used.
- May not require large plots of land and buildings to be carried out.
- Little losses incurred if there are fire outbreaks: The crops grow on a small piece of land and thus few losses are encountered in case of fire outbreaks.
- Requires little capital which can be afforded by most of the people for buying simple tools and inputs.

Criticisms of small scale subsistence production

Below are some of the criticisms of small production:

- Firms don't enjoy economies of scale. This is because they produce on a small scale and their output is low.
- Little incomes are earned by farmers because they are basically on low scale and for home consumption.
- It retards development of the agriculture sector since simple tools are used and scientific methods are not embedded so much.
- Low quality is produced since simple tools are used and poor farming methods are used.
- Vast lands may be underutilised since farmers prefer to concentrate of small pieces of land.
- Mechanisation is not possible since agriculture is carried out on small fragmented plots.
- Innovations and inventions may not be carried out and this will further limit specialisation leading to constant poor quality output.
- Little or no government revenue at all because of low output and only the incidental surplus is the one that is taken to the market.

9.3.4 Large scale commercial production

Activity 6

Basing on the case study 1 of this unit, answer the following questions:

(i) Mukeshimana is a ………………………….. type of farmer.

(ii) Describe the characteristics of the type of farming that Mukeshimana carries out.

(iii) Explain the advantages and disadvantages of the type of farming Mukeshimana carries out.

(iv) Why would you not advise Mukeshimana to continue her practices on that scale she is producing on.

Facts

Meaning

Large scale commercial production is the type of production that is carried out on a large scale. It normally involves large scale plantation farms that mainly deal in cash crops with high rates of specialisation. The major aim is production for sale either for internal processing industries or for the foreign markets. In Rwanda, these farms are common in areas of Byumba for tea growing, Musanze for Irish potato, Gisenyi, Shagasha in Nyamasheke, Kitabi among others. Related to the above, the industries under this type of production are so big that their products are also produced for export. Typical examples are Inyange industries, Sulfo industries, Braliewa among others. There are large mechanised plants purposely to produce goods for the market both internal and external. Large scale commercial production has the following characteristics:

- Normally done on large scale land covering wide areas.
- High output yields are got from the vast lands used.
- High rates of mechanisation especially if the areas are flat.
- High rates of specialisation normally concentrating on a particular commodity.
- High quality output is produced because of specialisation and use of machines.
- Production is for both domestic and foreign markets.
- Modern methods of farming are carried out like irrigation, use of fertilisers and machines among others..
- Normally labour carrying out large scale farming is trained with skills to cope up with the activity.

Advantages of large scale commercial production

Large scale commercial production is so important to the economy as discussed below:

- Encourages use of machines: Mechanisation is possible since it covers large pieces of land unlike small scale farming. This increases labour productivity and efficiency.
- High volumes of output: This comes from the wide pieces of land on which agriculture is used, use of specialists, use of correct and sufficient pesticides and fertilisers, and irrigation of farms in case of drought.
- Widens tax base: Tax base is widened from the produce and still the processing industries set up to increase the quality and also the workers in the farms. This increases tax revenue to the government.
- Leads to formation of industries. Agro-based industries come up so as to increase the quality of the products both for home and foreign markets.

- It leads to infrastructural development: Infrastructures like roads to link up the gardens and the markets, banks, electricity, which benefit both workers and the neighbouring community. This leads to efficiency and time saving.
- Employment creation: Many people are employed by the farms either directly and indirectly. This is because it employs hired labour like managers, accountants, transporters and marketers of products and farmers themselves.
- Improved skills: Specialisation is carried out and this helps the farmers to become perfect and improve skills hence high quality and quantity output.
- Field study and research. The large farms act as study purposes and fields for different agriculturalists as well as students.
- Easy to market large-scale output: Easy marketing can be carried out either domestically or internationally since the firms are big and therefore they can enjoy economies of scale. This increases the inflow of foreign exchange.

Demerits of large scale commercial production

Despite the advantages, large scale commercial production has elements as discussed below:

- Land exhaustion: Large scale production leads to land exhaustion and loss of soil fertility. This comes as a result of land being used constantly and not allowed to fallow long enough to regain its fertility, since the main aim is profit maximisation.
- Technological unemployment: This comes up because of the need to increase output, it requires a lot of machines since agriculture is carried out on a large scale.
- Surplus at the market: Due to large scale production, the output increases and this may not be all consumed due to low incomes of the people hence creating wastage.
- High capital is needed: Large scale production requires large capital for set up. This capital may not readily be available in developing countries.
- Requires skilled man power which is inadequate and worse still the experts seem to be very expensive.

- Displacement of people: Since it is done on a large scale, it requires large junks of land and because of scarcity, it may require displacement of some people.
- Reduction in the food needed by the local people: Most of the large scale farms produce output for export and the local population may not be left with goods. This may affect their standard of living.
- Leads to income inequality: This comes about when some farmers take on large scale commercial agriculture while others take on small-scale subsistence agriculture.

9.3.5 Agriculture specialisation

Activity 7

Referring to the case study 1 of this unit, answer the following questions:

(i) Mukeshimana's growing of only sweet potatoes is known as ....

(ii) Explain the advantages that Mukeshimana gains by growing only sweet potatoes.

(iii) Examine disadvantages that arise when carrying out her farming practices, due to production of only potatoes.

Facts

Meaning of agriculture specialisation

Agriculture Specialisation refers to the production of what one can do better. This results into abundant or surplus commodities which can be exchanged for other commodities. In agriculture, specialisation may involve concentrating on the growing of a particular crop and or keeping of a particular kind of animal. Specialisation is normally done by large scale farms and on a large scale with the aim of commercial purposes. In Rwanda, areas along Gatuna road are prominent for rice and tea growing, Ngoma is prominent for banana growing, Musanze for Irish potatoes, among others.

Advantages of agriculture specialisation

Agriculture specialisation has the following advantages:

- Time saving: Use of machines, specialised labour etc. makes it easy and quicker to produce within a short time since it takes little time to learn the job and there is no time wasted in moving from one job to another.
- Workers gain experience and skills: They become efficient as a result of repeating the same tasks.
- Enables mechanisation in agriculture: It encourages and makes possible the use of machines at various stages of production because of production in bulk.
  This leads to invention and innovations which lead to increased output.
- Proper exploitation and utilisation of natural resources: Regional specialisation and international division of labour enable regions or countries to exploit their natural resources and get what they cannot produce from other regions or countries.
- Economies of scale are enjoyed: It involves production in bulk and therefore enable firms to reap economies of large scale production.
- It improves the quality and quantity: Output produced by farmers is much and of better quality. This is because farmers gain experience that they use to produce better products.
- Mass production: Leads to mass production which at a national level increases the volume of exports and therefore improves a country's BOP position.
- Easy management: It is easier to manage production of one type of product than many because workers develop specialised skills due to concentration in the production of a single product.
- Easy marketing: It is easy to market a single crop or animal than several products to several buyers, in several locations and several prices.
- High quality production: The quality of output increases as farmers acquire better skills in a production of a given commodity. This leads to better prices and hence better income for the farmer.

Disadvantages of agriculture specialisation

Despite the advantages, agriculture specialisation also has disadvantages as discussed below:

- Leads to bulk production and surpluses: It involves production in bulk, which may be limited by insufficient markets in LDCs thus leading to wastage.
- Leads to seasonal unemployment: Division of labour can lead to seasonal unemployment since agriculture activities will be concentrated in few seasons. Since they are specialists cannot easily change to other jobs.
- Over dependence: International division of labour leads to over-dependence on other countries and also discourages diversification. In case of a decline in demand or fall in prices, the country would suffer.
- Repetition of the same work leads to boredom and monotony which dulls intelligence.
- It encourages the use of machines, which are specific and hence may not serve more than one purpose. It is also not easy to substitute men (labour) for machines. In case machines break down, firms may stop operating until other machines are secured.
- It leads to loss of craftsmanship: Workers cease to be craftsmen because of reliance on machines.
- It may lead to regional imbalances: Specialisation follows regional patterns based on climate, soils and altitude. Some regions specialise in high value crops and animals while others due to climatic and environmental reasons can only specialise in low products which creates income inequality.
- Exposure to risks: It exposes farmers to immense risks, e.g. in case of disease or climatic problems the farmer is completely denied of income for a long time since there are no alternatives to resort to.

9.3.6 Agriculture diversification

Activity 8

Referring to the case study 1 of this unit, answer the following questions:

(i) Mukamuganga's growing of cassava, sweet potatoes, maize and keeping goats is known as ....

(ii) Explain the advantages that Mukamuganga gains by growing all those crops.

(iii) Examine the disadvantage that arise due to carrying out all those production activities.

Facts

Meaning of agriculture diversification

Agriculture Diversification refers to the growing of a variety of crops and rearing a variety of animals. It may be through inter-cropping or growing the crops differently, while the animals may also be mixed i.e cows, goats and sheep or kept in separate herds of similar animals. Instead of specialisation, a farmer may decide to grow on a variety of crops and keep a variety of animals to avoid uncertainties. Normally a farmer who carries out diversification may get high returns due to the differences in tastes and preferences of people. Still, it leads to action of creativity where the farmer develops multiple skills needed in catering for different commodities.

Arguments in favour of agriculture diversification

Below are the arguments in favour of agriculture diversification:

- It reduces the risks of uncertainty that face agriculture sector especially when depending on one crop such as weather and pests.
- It widens the export base of the country since a variety is produced for export.
- It generates more employment opportunities because people are able to engage in a variety of activities.
- It increases and stabilises farmers' income because of selling a variety of crops and this reduces fluctuation in their incomes compared to when carrying out specialisation.
- Tax base of the government is widened because of a variety of activities on which taxes can be levied assuming that they are on a large scale.
- It increases on the variety of raw materials because more crops imply more raw materials which reduces the need for importing raw materials.

- It leads to economic growth because of the increase in the quantity of the goods produced and this reduces dependence on other countries for food.
- Rural urban migration is reduced because activities are carried out in rural areas and so the people in the village are able to get income for survival.
- It reduces economic dependence and creates self-sustenance since a country is able to have a variety needed in the economy and this reduces the B.O.P problem.

Limitations of agriculture diversification

Diversification of agriculture is limited by many factors as discussed below:

- Inadequate market: Most commodities from LDCs lack market because they are of poor quality, diversification will therefore increase output without market.
- Inadequate land: This is because the activities require large pieces of land which may not be available in LDCs.
- Conservativeness of the farmers who cannot change to grow a variety leading to agriculture remaining backward.
- Natural factors like floods, pests and diseases affect agriculture activities thereby limiting diversification.
- Underdeveloped infrastructure limits easy movement of the people and goods from one place to another.
- Inadequate capital leads to failure to buy the required inputs needed for growing crops.
- Credit facilities are rarely extended to farmers who would wish to diversify their activities.
- Poor and underdeveloped storage facilities limit the farmers because they would lack where to put the increased out put.
- Inadequate skills by the farmers limit them to participate in different activities.

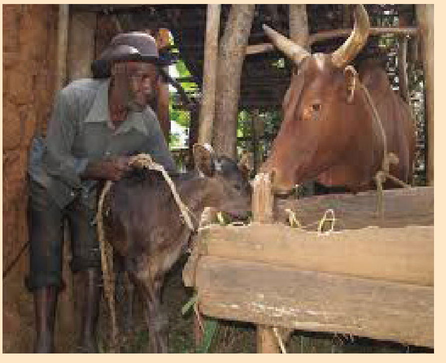
9.3.7 Intensive agriculture

Activity 9

Basing on the photos A & B in figure 4 below, discuss the following questions:

Figure 4: Economic activities

A



B

Required:

2. Describe the activities that are being carried out in the figures A and B above.
3. With reference to photos A and B above, identify the scale at which those activities are carried out.
4. Which type of farming do you think is practiced?
5. Examine the advantages and disadvantages of the type of farming in the photos above.

Facts

Meaning of intensive farming

Intensive agriculture is cultivation that involves using large amounts of labour and capital relative to the land area. Large amounts of labour and capital are necessary for the application of fertiliser, insecticides, fungicides, and herbicides to growing crops, and capital is particularly important to the acquisition and maintenance of high-efficiency machinery for planting, cultivating, and harvesting, as well as irrigation equipment where required.

Optimal use of these materials and machines produces significantly greater crop yields per unit of land than extensive agriculture, which uses little capital or labour. As a result, a farm using intensive agriculture will require less land than an extensive agriculture farm to produce a similar profit.

Advantages of intensive farming

Discussed below are the advantages of intensive farming:

- High-yield farming: One of the major advantages of intensive farming techniques is that the crop yield is high.
- Protection of livestock: Intensive farming helps the farmer to easily supervise and monitor the land and protect his livestock from being hurt or hounded by dangerous wild animals.
- Lower food prices: With the introduction of intensive farming, farm produce, such as vegetables, fruits, and poultry products have become less expensive. It also aids in solving the worldwide hunger problems to a great extent. This means that common people can now afford a balanced and nutritious diet.
- Economical infrastructure: Many agree that organic food can be afforded only by the elite strata of the society. Apart from that, large farming spaces are required to cultivate organic crops using natural manure. However, with the introduction of intensive farming, the space, equipment, and other requirements for farming are less and more economical.
- Regulated farming: The EPA (Environment Protection Agency) has set certain rules and regulations on how livestock, pesticides, and animal manure are to be maintained. The farmers, who follow these set rules help to provide an affordable, safe, and healthy produce to all alike.
- Sustaining food supply with the demand: Another advantage is that large productivity of food is possible with less amount of land. This leads to economies of scale and directly contributes towards meeting the ever-growing demand for food supplies.

Disadvantages to intensive farming

Despite the advantages, intensive farming has disadvantages as discussed below:

- Poor living conditions for livestock: Intensive farming involves the use of various kinds of chemical fertilisers, pesticides, and insecticides. Apart from this, it is also associated with farms that keep livestock above their holding capacity, which in turn leads to pollution, various diseases, and infections brought about by overcrowding and poor hygiene.
- Heavy deforestation: Reports and studies reveal that intensive farming affects and alters the environment in multiple ways. Forests are destroyed to create large open fields, and this could lead to soil erosion. It affects the natural habitat of wild animals. Use of chemical fertilisers contaminates soil and water bodies, such as lakes and rivers.
- Excessive use of fertilizers and pesticides: Pesticides sprayed on crops not only destroy pests and contaminate the crops, but also kill beneficial insects. Heavy use of pesticides and chemical fertilisers also affects workers (who spray the pesticides) and the people residing nearby. Eventually, these chemicals are passed on to the human beings, who consume the agricultural produce.
- Damage on crops and human life: Fruits and vegetables purchased from farms that promote intensive farming are covered with invisible pesticides. These cannot be washed off easily. Exceeding the use of pesticides affects the health of human beings severely, leading to skin allergies, physical deformities, and congenital diseases.
- Use of chemical hormones in food: There are many hybrid varieties of livestock, plants, and poultry available today. The livestock and poultry are injected with hormones and other chemicals to increase the yield.
- Higher risk of cancer: Statistics show a direct relation between the consumption of food procured from intensive farming sites and an increase in the number of cancer patients and children born with defects. Researchers opine that consumption of inorganic poisonous vegetables, fruits, poultry, and meat could probably be one of the reasons causing such damage in the human body.

9.3.8 Extensive agriculture

Activity 10

Basing on the photos A & B in figure 5 below, discuss the following questions

Required:

i) Describe the activities that are being carried out in the figures A and B above.

ii). With reference to photos A and B above, identify the scale at which those activities are carried out.

iii). Which type of farming do you think is practiced?

iv). Examine the advantages and disadvantages of the type of farming in the photos above.

Figure 5: Farming practices

	
A	*B*

Facts

Meaning of extensive agriculture

Extensive agriculture is a system of crop cultivation using small amounts of labour and capital in relation to area of land being farmed. The crop yield in extensive agriculture depends primarily on the natural fertility of the soil, terrain, climate, and the availability of water.

Extensive agriculture is distinguished from intensive agriculture in that the latter, employing large amounts of labour and capital, enables one to apply fertilisers, insecticides, fungicides, and herbicides and to plant, cultivate, and often harvest mechanically. Because extensive agriculture produces a lower yield per unit of land, its use commercially requires large quantities of land in order to be profitable. This demand for land means that extensive agriculture must be carried on where land values are low in relation to labour and capital, which in turn means that extensive agriculture is practiced where population densities are low and thus usually at some distance from primary markets.

Advantages of extensive agriculture

Below are the advantages of extensive agriculture:

- Less labour per unit area is required to farm large areas, especially since expensive alterations to land (like terracing) are completely absent.
- Mechanisation can be used more effectively over large and flat areas.
- Greater efficiency of labour means generally lower product prices.
- Animal welfare is generally improved because animals are not kept in stifling conditions.
- Lower requirements of inputs such as fertilisers.
- Local environment and soil are not damaged by overuse of chemicals.

Disadvantages of extensive agriculture

Despite the advantages, extensive agriculture has disadvantages as discussed below:

- Yields tend to be much lower with intensive farming in the short term.

- Requires watering plants regularly and this may be quiet costly leading to high costs of production.
- Since it requires large lands, it may need high mechanisation which is costly for the poor farmers.
- Wild fires can destroy the large acres of plants and this causes large amounts of losses.
- Land exhaustion: This comes as a result of land being used constantly since the main aim is profit maximisation and it creates infertility and low production in the long run.
- Technological unemployment comes up because of the need to increase output. Still the agriculture is done on a large scale which requires a lot of machines that are also high in terms of costs.
- Surplus at the market: Due to large scale production, the output increases and this may not be all consumed due to low incomes of the people hence creating wastage.
- High capital is needed: Extensive production requires large capital for set up. This capital may not readily be available in developing countries.
- Requires skilled man power which is inadequate and worse still the experts seem to be very expensive.
- Displacement of people: Since it is done on a large scale, it requires large chunks of land and because of scarcity, it may require displacement of the people.

9.3.9 Agricultural practices.

Activity 11

Basing on the knowledge and understanding from the research carried out in activity 3 of this unit, analyse the photos A, B and C in figure 6 below, discuss the following questions.

Required:

(i) How do you describe the agricultural practices shown in the photos A and B? Clarify your answer.

(ii) What does image c in figure 6 above indicate?

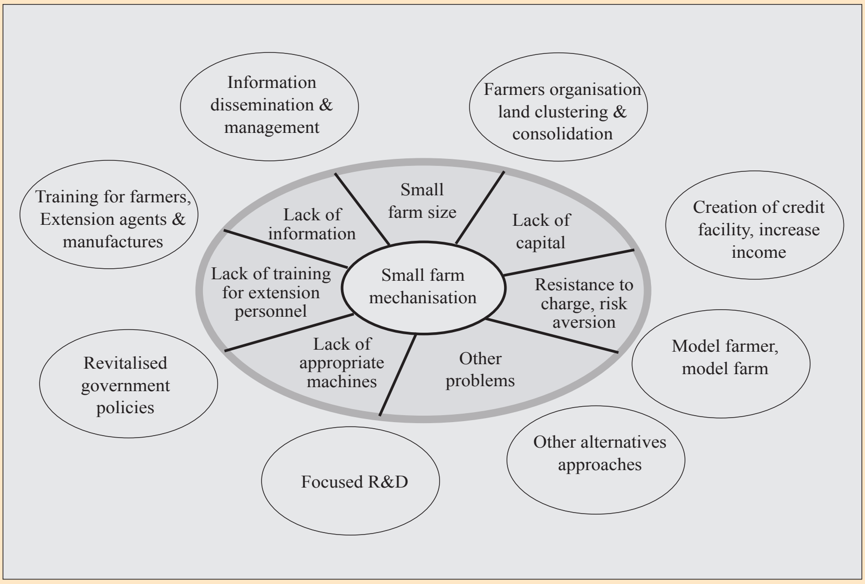
(iii) What are the advantages and disadvantages of using the above-mentioned agricultural practice methodology?

(iv) Why do you think the above method is uncommon in most agricultural farms in Rwanda?

Figure 6: Agricultural practices

A

B



C (problems and solutions of agriculture mechanisation)

Facts

Meaning of agriculture mechanisation

Agriculture Mechanisation is part of agriculture modernisation that involves the use of capital intensive techniques such as tractors, harvesters, irrigation pumps, ploughs and milking machines, among others, in the production process. Normally the ratio of labour to machine is too low meaning that the number of workers are few and the work is basically done by machines but under human control. This becomes viable if done on large scale because the cost of production would not be high compared to the output. It is normally done to increase quality and quantity and also for time saving.

Arguments in favour of agriculture mechanisation

Some of the advantages of mechanisation of agriculture can be discussed below:

- Mechanisation is time saving especially during times of planting, ploughing among others. The machines do the work very quickly which saves time.
- Mechanisation encourages large scale production because machines use large pieces of land and this increases output that would be exported to earn the country foreign exchange.
- Good quality output is produced because of constant use of machines which can be tuned and adjusted to produce good quality.
- It reduces the cost of production because the expenditure to buy machines is not recurring but happens once compared to labour that has recurring expenditures.
- It encourages specialisation depending on the machines which the farmers have and this leads to increased in quality and quantity and saves time.
- Easy management because the use of machines doesn't need supervision which is not the case with labour.
- Machines can act as collateral security when acquiring loans from financial institutions.
- Irrigation can be done. This reduces dependence on nature and output increase, even during dry periods.

Disadvantages of agriculture mechanisation

Discussed below are disadvantages of agriculture mechanisation:

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

- Rural urban migration may occur because mechanisation requires large pieces of land and therefore the local people may lack land for settlement .
- Requires large sums of capital to use because the machines such as tractors, sprinklers and harvesters have to be imported.
- Machines destroy the ecology of the soil since they may not be appropriate for the soil.
- Requires large pieces of land and this is a problem in Rwanda where land has rugged terrain with steep slopes.
- Specialisation as a result of mechanisation may affect the country incase world market prices fall.
- Over production: This is because of the work easily done by machines during the process and this leads to surplus and resource wastage.
- Over exploitation of resources due to the desire for the high profits and excess production by the machines.

Limitations of agriculture mechanisation

There are many limitations of agriculture mechanisation some of which are discussed below:

- It requires high skills to operate the machines which lack in the developing countries due to inadequate training.
- It requires large amounts of capital to implement which capital is lacking on the side of the farmers.
- Requires large pieces of land which is scarce in LDCs where the land is divided into small pieces called fragments.
- Relief of the area may not be suitable for the machines. The rugged terrains of Rwanda like in the areas of Northern Province have steep slopes which make mechanisation difficult..
- Attitude towards mechanisation is very poor because of high levels of illiteracy, cultural beliefs and poverty.
- Requires a good and efficient agricultural planning which is not possible in terms of costs and management in LDCs.
- The approach may be inapplicable where human judgment is necessary during the production process.

- Underdeveloped infrastructure and technology limits the use of machines since they require a well-developed road network.
- Small market for the output discourages the farmers from using machines so as to increase output since it may lead to surplus and a fall in prices.
- Poor land tenure system where land is divided into fragments and owned by absentee landlords.
- Machines sometimes destroy the ecology of the soil since they may not be appropriate to the structure.

9.3.10 **Commercialisation of agriculture**

Activity 12

Basing on the knowledge and understanding from the research carried out in activity 3 of this unit on the approaches to agriculture development, analyse the photos A, B, C and D in figure 7 below and discuss the following questions.

Figure 7: Economic activities

Required:

(i) Describe the economic activities shown in the photos A, B C, and D.

ii) The activities above are mainly for?

(a) Home consumption (b) Market (c) None of the above.

iii). What are the benefits and demerits of using the agricultural practice in carrying out activities in the photos above?

iv). Explain why using such a methodology in carrying out agricultural activities is not common in your home areas.

Facts

Meaning of commercialisation of agriculture

Commercialisation of agriculture is the type of production that is intended for sale with an aim of getting profits. It normally involves large scale production with high technology. The quality tends to be better than that of subsistence production. In Rwanda, the major food crops grown for sale include Irish potatoes, banana, and rice among others while the cash crops include tea and coffee. Among the animals are cows for beef and milk, goats and sheep among others. Commercial production involves the following characteristics:

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

Benefits of commercial agriculture

Below are the benefits of commercial agriculture:

- Development of the skills of workers because of specialisation and constant doing of the same work.
- It increases the gross domestic product of the country because of the need for high profits and revenues.
- It increases the incomes of the workers and the farmers at large. This is because production is for sale. This increases the standard of living of the workers.
- Good quality products improve the standards of living of the people and their way of life.
- It increases the exports of the country hence the increase in the foreign exchange earnings.
- It increases the supply of food since there is production on largescale for domestic and foreign markets.
- Increased supply of raw materials in the country: Commercial agriculture supplies more raw materials to industries especially agro based industries thus promote industrialisation.
- Capital accumulation may increase because of increased output for sale that will bring in revenues.
- Sometimes it is done on a large scale so it utilises the idle land that may be unproductive.
- Employment creation: The desire for too much profits make the owners of the farms to increase the number of workers hence creating employment.

Disadvantages of commercial agriculture

Some of the disadvantages of commercial agriculture are discussed below

- Reduction in the food needed by the local people since production is mainly for sale and not home consumption.
- Capital intensive techniques cause unemployment in the villages since machines are mainly used on extensive lands.
- Requires large sums of capital to use because the machines such as tractors, sprinklers, harvesters, all have to be imported.
- Requires large pieces of flat land and this is a problem in Rwanda where land has rugged terrain with steep slopes.

- Specialisation as a result of mechanisation may affect the country in case world market prices fall.
- Over production: This is because of the work easily done by machines during the process and this leads to surplus and resource wastage.
- Over exploitation of resources due to the desire for the high profits and excess production by the machines.

Limitations of commercial agriculture

Commercial agriculture is limited by the following factors:

- Poor weather conditions: Sometimes the rains fail to come and other times there are floods. All these are a problem to the farmers since there are differences between planned output and actual output.
- Poor land tenure systems. Some of the land is owned by absentee land lords and hence it is inactive.
- Narrow markets: The market is low due to poverty among the people and the low quality that cannot yield much revenues.
- Poor infrastructure: This limits the movement of goods from gardens to market and also from areas of low prices to areas of high prices.
- Lack of skilled manpower: Most of the people have low skills and worse still they take long to adjust to the new techniques.
- Conservatism of farmers: Some farmers are very conservative and are not able to change to good quality output hence end up getting low revenue.
- Inadequate capital: This is still very low and the low producers cannot access the improved equipments necessary to improve the quality and quantity.
- Competition from other countries that produce the same at the world market. This leads to surplus and constant price fluctuation which affects the foreign exchange and incomes of the farmers.

9.3.11 Agriculture co-operatives

Activity 13

Basing on the knowledge and understanding from the research carried out in activity 3 of this unit, on the approaches to agriculture development, analyse the photos A, B, C and D in figure 8 below and discuss the following questions.

1. Identify the products that are produced by the farmers identified in the photos above.
2. How do you think they carry out their farming practices?
3. Give examples of such agriculture practices in your locality.
4. There are many of such groups in the Rwanda, which body is responsible for them all together?
5. What are the rules governing such farmers in your home area?
6. How are such groups of farmers and their farming practices described in the photos above important in your community and to the entire economy?

Figure 8: Agricultural farmers

Facts

Meaning

Cooperatives are business organisations owned by their own users who select a governing committee with an aim of achieving common objectives. There are many types such as; marketing cooperatives, producer cooperatives, transport cooperatives, consumer cooperatives, credit and savings cooperatives, trade and craft societies e.g. hand craft, building and construction societies but our main concern are the agriculture cooperatives that may involve both the producer and marketing cooperatives.

Agricultural cooperatives are business organisations formulated and owned by farmers who come together to achieve common objectives. Typical examples of these cooperatives include KEHMU (koperative ejoheza muhinzi w' umuceri), KOIMUNYA (Koperative Imbazabigwi Muhinzi w' Umuceri Nyakabuye), copro-mabya in the north dealing with passion fruits, COTHENYA dealing with tea in Nyaruguru etc.

Principles of cooperatives

Every organisation has its own principles on which it is based and below are those of cooperatives:

- They have open membership: This means that everyone is free to join provided he or she can pay the membership fee.
- They are financed by members themselves through the membership fees they pay.
- Leaders are elected democratically by the members of the cooperative through a one man one vote process.
- They are supposed to be impartial meaning that they are not based on politics, religion among others.
- Cooperative education is supposed to be provided to members, workers and the general public by the cooperative.
- Members should have access to records of the cooperative so as to follow its progress.

Roles of cooperatives to development

Cooperatives have many roles they play towards the development of the country and among a few are the following:

- They participate in the production of goods and services, say in agriculture, industry, transport among others.
- Cooperatives help farmers to market their products eg. coffee, maize, tea etc.
- They participate actively in the transportation, collection and storage of products.
- They provide farmers with cheap inputs like fertilisers, hoes etc.
- They provide education to members and to the public on how to use the fertilisers, new tools and new methods of production.
- They increase cooperation among the people and this brings unity in the society.
- They help members to get credit facilities through mobilising funds from financial institutions.
- Co-operatives provide members with cheap consumer goods, i.e. they buy in bulk and sale in smaller quantities at lower prices to members than non members.

Problems facing cooperatives in LDCs

Despite the roles seen above, these cooperatives are still faced with many obstacles as seen below:

- Shortage of skilled personnel to work as top management staff.
- Politics tend to interfere in the activities of the cooperatives especially when choosing leaders.
- Shortage of capital and credit facilities to expand their businesses.
- Many members especially in the rural areas are illiterate and tend to be conservative and not easy to educate.
- Dishonesty of some members who sometimes sale commodities to private buyers instead of selling through their cooperatives.
- Most members are poor and they delay to pay subscription (cooperative fees).
- Marketing cooperatives experience shortage of facilities for transportation, storage, and packaging among others.
- Lack of commitment among the leaders who do their own activities instead of carrying out cooperative services.
- Some members tend to use cooperative assets for their own benefit and end up spoiling them in activities which are not for cooperatives. This increases management costs.

9.3.12 Agriculture research and extension services

Activity 14

Visit the library or the internet and undertake research on Agriculture research and extension services and share your views about the following;

(i) How do farmers get information about their agriculture practices?

(ii) Who is responsible for the agriculture services in your local areas?

(iii) Identify some sources from where Rwandan farmers can access agriculture information.

(iv) What information do you think farmers need to look for?

(v) Of what importance is such gathered information to Rwandan farmers? And what do you think hinders Rwandan farmers from accessing such information they need about their farm practices?

Facts

Meaning of agriculture research

With reference to agriculture, research means scientific investigation or study with a view of improving production techniques in order to increase the existing quantity and quality of agricultural output.

Agriculture research can be carried out in the following areas:

(i) Scientific discoveries in new crop and animal varieties.

(ii) Research in new techniques of production.

(iii) Studies in soil science.

(iv) Market research i.e. obtaining information about market for firm products.

(v) Research on climatic conditions seasons with respect to crop requirements.

Importance of Agriculture research

Agriculture research is important in the following ways:

- It leads to introduction of high yielding crop and animal varieties which leads to increase in the quantity and quality of farm products.
- It reduces the cost of production and saves time, eg. research in agriculture modernisation.
- It leads to improvement in land use through better farm management techniques.
- Research into soil science leads to soil conservation which controls soil exhaustion.
- Research on climatic conditions helps farmers in early planting and early harvesting.
- Through market research, a farmer is assured of market for her produce at fair prices.
- Research into disease and pest control methods reduces risks and uncertainties in agriculture.
- Research facilitates specialisation and division of labour through introduction of mechanisation.
- Farmers benefit from extension services/ education from researchers through dissemination of research findings.

Limitations of agriculture research in LDCs

Research in agriculture is limited by the following:

- Limited capital: LDCs have insufficient funds to finance research experts and facilities which results into borrowing.
- There is limited skilled personnel to carry out research and disseminate research findings hence necessitating foreign experts who are expensive.
- Political instability and insecurity in most parts of LDCs limits research.
- Limited research findings tend to enable agriculture development.
- Poor infrastructure like storage facilities, water, power etc.
- Poor transport and communication facilities limit movement of people and researchers.
- Conservatism and illiteracy among agriculturalists that do that want to implement what has been improved.

- Low income among farmers who cannot afford better breeds and farm implements lead to continuous production of low quality output.
- Failure to translate research results into projects makes the project a waste of time and money.

Agricultural extension services

Agriculture research findings can reach farmers through extension services. Agricultural extension service is the application of scientific research and knowledge to agricultural practices through farmer education. Generally, agricultural extension can be defined as the "delivery of information and inputs to farmers." It can be carried out through seminars,short study courses, visits to farmers by agriculture experts, tours by farmers to demonstration farms, use of mass media, etc.

Objectives of agriculture extension services

- To provide knowledge and help for better management of farms and increase incomes.
- To encourage the farmers to grow their own food, eat well and live well.
- To promote better social, natural recreational intellectual and spiritual file among the people.
- To raise the standard of living of the rural people by helping them in right use of their resources.
- To help in planning and implementing the family and village plans for increasing production in various occupations.

Merits of agriculture extension services

Agriculture extension services have the following merits:

- Extension uses democratic methods in educating the farmers. This helps farmers to improve their methods of farming.
- Extension helps in adoption of innovations to farmers such that they are able to shift from the traditional methods to the modern methods.
- Extension helps in studying and solving the rural problems that may be affecting the rural farmers during the production process.
- Extension increases farm yields and improves the standard of living of farmers through the increased incomes got.
- Extension contributes to national development programmes such as agricultural development and modernisation.
- Research helps in increasing efficiency in agricultural production. The output per farmer increases and it is done in the shortest time possible.
- Research helps in increasing efficiency in marketing, distribution and utilisation of agricultural inputs and outputs.
- Conservation, development and use of natural resources are carried out since it is part of the education that is passed on to the people.

Limitations of agriculture extension services

Agriculture extension services are limited by the following:

- Inadequate capital to carry out the research that is needed by the people.
- Ignorance of the people who do not always attend extension services. Some people are ignorant about the services so they rarely attend. This leads to lack of knowledge about the new services.
- Inadequate skilled man power to carry out the trainings and research is a major problem affecting the low developing countries.
- Poor land tenure system that may sometimes not allow the people to practice what they have studied.
- Illiteracy among the people who sometimes don’t know how to read and write hinders them to acquire knowledge.
- Inadequate materials to use during the training due to inadequate capital by the organisers.

9.3.13 Land ownership

Activity 15

Use the library or the internet or any other economics resource to research about land ownership and thereafter answer the questions that follow.

(vi) What do you understand by the term land ownership?

(vii) Which body is responsible for land registration and use in Rwanda?

(viii) How does land ownership affect agriculture practices in Rwanda?

(ix) Describe how the government of Rwanda has influenced agriculture development through land policies.

Facts

Meaning of land ownership

Land ownership or land tenure system is a system by which a person, community or state has legal authority to land. It can as well be referred to as land tenure system. A landholder/landowner is a holder of the estate in land with considerable rights of ownership or, simply put, an owner of land. In African countries, land is owned through either individual ownership, customary or state ownership among others.

Table 1: Land cover in Rwanda

Land cover types	Area (ha)	% of the total
Potential arable land (land actually under agriculture)	1.612.068	61
Wetlands	278.536	10
Forest	240.746	10
Water boy (lakes and rivers)	176.050	6
Protected areas (parks)	226.400	8

Towns and highways	100,000	5
Total	2,633,800	100

Sources: UNDP/SLM and REMA, 2009

Table 1 above shows how land cover in Rwanda is distributed under agriculture, wetlands, forest, water body and national parks.

Forms of land ownership

The laws that govern land ownership may be written by the state of customary and they vary from one country to another. Below are some of the forms of land ownership in developing countries:

1. Customary or communal land ownership

Under this system, land is commonly owned by the people in the society. Every individual is free to use the land and it's the reason why the people are not allowed to have demarcations on the land and neither are they allowed to build permanent structures. Under this system, land is owned by clans, families or tribes. This type of land ownership is common in the pastoral areas of Karamoja in Uganda and the Masai of Kenya and Tanzania. Since they wonder with the cattle, they rarely build permanent structures.

2. Individual ownership (freehold land ownership)

Under this system, individuals are free to own land privately. This could be through buying it from people or through inheritance. The individual is solely the owner of the land after acquiring the land title and he has the right over his or her land to either give it away or pass it over to the next party in the family.

3. Leasehold land ownership

Under this system, land is owned by rich landlords who then can rent it through lease to persons who may be interested and sometimes companies. The tenant i.e. person who takes over the land, pays large sums of money and the period of rent depends on the agreement between the two parties. The tenant is thus able to carry out any activity provided it does not violate the terms and conditions agreed by the two parties.

4. *Feudal system*

This one can be found in Buganda in central Uganda and Swaziland where land was allocated to the king by the colonialists. The king would then distribute the so called "9000 miles of land" to his chiefs basing on their location and the importance of work they would be doing for the king. In Swaziland as well, the king received the land from the colonialists and it has been passed over from one generation to another.

Land reforms in Rwanda

The Vision 2020 and the medium term strategy (the EDPRS) have focused on land administration and land use management as key areas for the land reform process that will support sustainable development. These efforts have come up against significant challenges such as population pressure in both urban and rural areas which have led to land degradation. Presently, there are efforts to develop a national land use master plan which will subsequently be translated into local plans to guide zoning for activities including agriculture, urbanisation, resettlement, public infrastructures, and biodiversity conservation.

The realisation of these efforts are likely to provide appropriate interventions for land degradation which will lead to enhanced agricultural productivity. Additionally, the appropriate location of activities informed by land suitability assessments will ensure that resettlement patterns, public infrastructure and the overall urbanisation process provides the right kind of interventions for urban environmental issues in particular and proper national planning targeted at promoting environmental management in support of sustainable development.

In order to achieve economic growth and development and the presence of absentee landlords, land has been left idle and unproductive. This has led to reforms which may contribute to the gross domestic income. The common land reforms in Rwanda.

1. Land redistribution: This involves change of land tenure system whereby land is redistributed to different people who develop it. The land owned by absentee landlords has been given to other people for development.

2. Land consolidation: This involves removing the fragments in the land so as to make it available in large quantity for extensive agriculture. In Rwanda land has been consolidated for basically large scale agriculture
3. Land taxation: This involves taxing idle land so that the owners can make it productive by utilising it appropriately.
4. Land reclamation: It involves reclaiming the land that may have been washed away by running water into river beds. This is done to create more land for agriculture. It is common in areas along Nyabarongo river especially towards Bugesera district at a place called Mugendo. Most of the land has been reclaimed to create space mostly for sugar cane growing and other types of food crops.
5. Land registration: This involves claiming ownership of the land by registering it at the land registration offices and acquiring land titles . This is done at all district headquarters in offices in charge of the lands.
6. Removal of communal land so as to have individual ownership of the land for better development.
7. Resettlement schemes: This involves shifting people from some areas that may be catastrophic and vulnerable to natural disasters.
8. Land development laws: This is especially during construction of buildings where the land developer is required to acquire a construction license from the district. In Rwanda, construction of permanent structure requires the developers to first get a construction license.

Unit assessment

1. (i) Mutoni a farmer in Gicumbi district has been producing beans, cow peas and ground nuts. Explain the advantages that she will get by concentrating on producing beans alone.
   (ii) What problems is she likely to face during the above process?
2. In Rwanda using machines has not been very common. Explain the reasons behind this scenario.
3. (i) Using characteristics, explain the difference between growing foods on a small scale and growing on a large scale.
   (ii) What form between the two above is suitable for Rwanda and why?
4. Farmer's associations in Rwanda are very vital for development. How helpful are they to both the farmers and the country at large?

Glossary

- **Agriculture mechanisation**: A part of agriculture modernisation that involves the use of capital intensive techniques such as tractors, harvesters, irrigation pumps, ploughs and milking machines, and other machinery in production process.
- **Agriculture specialisation**: This involves concentrating on the growing of a particular crop or keeping of a particular kind of animal.
- **Agriculture diversification**: The act of engaging in growing a variety of crops and rearing a variety of animals.
- **Agriculture co-operatives**: Agriculture business organisations formulated and owned by farmers who come together to achieve common farming objectives.
- **Agricultural extension**: The application of scientific research and knowledge to agricultural practices through farmer education.
- **Agriculture**: The growing of crops and raring of animals.
- **Agriculture development**: The process of promoting proper conditions for farming so that the quantity and quality improve drastically.
- **Commercialisation of agriculture**: A type of production that is intended for sell with an aim of getting profits.
- **Development process**: A system of defined steps and tasks such as strategy and organisation that are used to convert ideas into commercially viable goods and services.
- **Development strategy**: A set of guidelines which a country should follow in formulating and implementing long term policies meant for development.

- **Extensive agriculture**: A system of crop cultivation using small amounts of labour and capital in relation to area of land being farmed.
- **Intensive agriculture**: A system of cultivation that involves using large amounts of labour and capital relative to land area.
- **Land ownership**: A system by which a person, community or state has legal authority to land.
- **Large scale commercial production**: A type of production that is carried out on a large scale.
- **Modernisation approach**: A method of encouraging agriculture development that aims at improving the existing framework to increase the quality and quantity of output.
- **Small scale subsistence production**: A situation where all the activities that are done in agriculture are done on a small area.
- **Transformation approach**: This involves a complete and total change in the existing agricultural sector practices and systems.

Unit summary

- Development process and strategies
  - Meaning of agriculture development
  - Goals of agriculture development
- Agricultural development strategy
  - Meaning of agriculture development
  - Merits and demerits of agriculture development
- Approaches to agricultural development
  - Transformation and modernisation
  - Small scale and large scale production
  - Agriculture specialisation and diversification
  - Extensive and intensive techniques
  - Mechanisation of agriculture

Topic Area 5: Development Economics

Sub-Topic Area 5.2: Development Process and Strategies

UNIT 10 Industrial Development

Key unit competence: Learners will be able to analyse the contribution of development strategies on the economy.

My goals

By the end of this unit, I will be able to:

- Explain the meaning, advantages, disadvantages and limitations of industrial development.
- Compare and contrast the meaning, merits, illustrations and limitations of labour and capital intensive techniques of production.
- Examine the meaning, advantages, disadvantages and limitations of intermediate and appropriate technology.
- Differentiate between technology transfer and technology development.
- Assess the role of technology transfer to the development of Rwanda.
- Compare the features, advantages, disadvantages and limitations of small scale and large scale industries.
- Analyse the advantages, disadvantages and limitations of import substitution and export promotion industrial strategy.

Activity 1

Using the photos, a, b, c and d below, discuss the following questions:

Figure 1: Industrial activities

Required:

(i) Identify the products that are produced by the industries identified in the photos below.

(ii) Categorize the different activities named above in their respective industries.

(iii) What general name would you give to the development of the above activities all together?

(iv) Cite different other firms that do different activities in Rwanda that do not fall under any category named in ii) above.

(v) How would you distinguish between an industry and industrial development?

(vi) Assess the impact and limitation of industrial development in Rwanda.

Facts

10.1 Meaning of Industrial Development

Industrial development involves putting up manufacturing, processing, mining and construction plants among others with an aim of improving the output produced together with better standards. It may involve putting in place and developing the infant industries. Infant industries are industries which have just started operating and therefore have a small market, low output and high average costs.

10.1.1 Classification of industries in Rwanda according to activities, ownership and location

Table 1: Industry classification in Rwanda

Industry	Activity	Name of the industry	Ownership	Location
Manufacturing and processing industries	Cement	Cimenterie du Rwanda (CIMERWA)	Private and public	Rusizi -Bugarama
	Cigarettes	Rwigass cigarettes company	Private	Kigali -Kicukiro
	Juice	Inyange industry Nyirangalama industry	Private	Masaka-Kigali Nyirangalama -Rulindo
Mining	Mining and processing	Wolfram mining and processing LTD	Private	Karuruma-Kigali Nyirangarama-Rulindo in Bushoki sector

Construction	Housing and commercial	Caisse Social du Rwanda (CSR)	Public	Muhima-Nyarugenge
		RAMA	Public	Muhima-Nyarugenge
	Construction	Horizon construction	Public	Gikondo-Nyarugenge
		NPD- contraco SARL	Private	Niboye-Kicukiro
		Real constructors Sarl	Private	Muhima-Nyarugenge
		Fair construction	Private	Gikondo-Kicukiro
		ROKO-Rwanda sarl	Private	Gikondo-Kicukiro
Electricity	Energy generation and distribution	EDCL	Public	Nyarugenge-Nyarugenge
Water industries	Water processing and distribution	WASAC	Public	Kimisagara-Nyarugenge
	Water processing and packing	SULFO Rwanda industries	Private	Muhima-Nyarugenge
		Inyange industries	Private	Nyarugunga-Kicukiro
		Urwibutso Ese (Nyirangarama)	Private	Nyirangalama-Rulindo
		Huye industries	Private	Nyabihu-Huye

Table 1 above shows examples of industries under different classifications.

The government of the republic of Rwanda has embarked on massive infrastructure development, in particular, roads and industry as seen by the allocation of gazetted lands to industrial development in Masoro. This increased industrial development in Rwanda is the major engine to economic growth and development as well as improving the standards of living of people through job creation and good quality output.

10.1.2 **Advantages of industrial development**

Despite the numerous advantages brought by industrial development, it also has problems that it brings not only to the environment but also to the economy at large as seen below;

- Industrial development provides well-sustained economic growth that can transform an economy. Industrial growth and economic growth go hand in hand. For example, economies thrive due to more jobs, more money, and more opportunity. It is often linked with higher wages, high production, more money and more services for the economy leading to higher income per capita and more labor productivity thus increasing the standard of living. These opportunities can transform the economy inspiring endless amounts of growth.
- Industrial development leads to an increased demand for goods and services, therefore promoting more innovation and more financial opportunity which profits the entire community.
- Prices of industrial products tend to be stable for a long period. This price stability is a sign of development.
- Industrial development provides forward and backward linkages to agriculture, forward linkages are provided by providing market to its produce by processing it, and backward linkages by providing it with tools to use. These linkages bring about development.
- Industrial development requires relatively less land, so, it is the most appropriate development strategy for developing countries whose land is reducing due to persistent increases in the population size.
- Prices of industrial products are high, so the industrial sector fetches more money for the economy both locally and internationally.

- Industrial development is necessary for modernisation of agriculture. To increase agriculture productivity, there is need of chemical fertilizers, pesticides and weedicides, tractors, threshers, pump sets harvesters etc.to modernize agriculture, of which are all industrial products. Without industrial development, these goods cannot be produced. Agricultural products like cotton, sugarcane etc. are raw materials to industrial production in preparation of finished products like textiles and sugar etc. So industrial development is necessary for modernisation of agriculture.
- Industrial development diversifies and raises government tax revenue. The industrial firms developed, labour, employed and output produced are all taxed to increase tax revenue.
- Industrial development encourages the development of science and technology. The industrial enterprises conduct research and develop new products. Industry conducts research on its wastes and develops byproducts; this makes an economy to thrive in technology in all corners of the economy.
- Industrial development facilitates infrastructural growth; industry requires hydroelectric power to run its machines and roads to transport its output and input to and from the industry. Consequently, intending industrialists induce government to set such infrastructure up or they set them up themselves. This develops the economy.
- Industrial development provides more employment opportunities to all nationals; the different linkages created by the industrial sector employ the almost all nationals i.e. educated, semi-skilled, and the unskilled.
- Industrial development increases the availability of foreign exchange and improves upon the balance of payment position of the country. Foreign industrialists come with foreign currency; in addition, the excess of the industrial sector is exported to fetch more foreign exchange. This increases the foreign exchange reserves of the nation so development.
- Industrial development helps in capital formation because in large scale industries, the surplus is very high. By using external and internal economies, industry can get higher profit which can be reinvested for expansion and development.

- Industrial development promotes Urbanization. This is because industrialisation in a particular region brings growth of transport and communication, schools, colleges, technical institutions, banking and health facilities are established near industrial base. Many ancillary units can be established after setting up of big industry. This promotes urbanization as one of the indicators of economic development.
- Industrial development promotes self-reliance in different ways. For example, during war and emergency or any other form of catastrophe and in case of any economic hardships, dependence on foreign countries for war weapons, food and medical relief may prove fatal. Self-reliance in capital and consumer goods and industrial infrastructure is also necessary thus the need for industrial development.
- Industrial development plays an important role in the promotion of international trade. Industrial products command higher values & their demand is inelastic, thus making a country to gain from trade. To meet the deficit in balance of payments, a country needs to produce import substitute products or go for export promotion through industrial development.
- Industrial development plays important role in proper utilisation of resources by a country. It makes a country to properly utilize her resources to transform them into finished industrial products.
- Rapid industrial development helps a country in quick alleviation of Poverty and Unemployment. Since the slow growth of industrial sector is responsible for widespread poverty and mass unemployment in most developing countries, fast growth of industrial sector, may be helpful in eradicating poverty and unemployment more especially in rural areas.
- Industrial development helps in the rapid growth of national and per capita income. The history of economic development of advanced countries shows that there is a close relation between the level of industrial development and the level of national and per capita income.
- Industrial development is a sign of higher standard of living and social change: This is because it helps a country to produce goods and services of high quality in order to attain decent living standard.

10.1.3 Disadvantages of industrial development

Despite the numerous advantages brought by industrial development, the industries also have problems that they bring not only to the environment but also to the economy at large.

- Industrial development pollutes the environment. The fumes from machines spoil the atmosphere, industrial waste is poured in the waters, and there is noise. All these endanger the lives of the people so worsening their welfare and delaying development.
- It worsens rural-urban migration and its side effects like slum development in urban centers, congestion of traffic and under development of rural areas. This is mainly because industries are set up in urban centers.
- It increases capital flight; the foreign industrialists who are the majority in the sector take back all the benefits from the sector rather than re investing it in developing countries. This further under develops the country.
- It increases technological unemployment in LDCs. This is mainly because of the high use of capital-intensive techniques of production in the industrial sector. Therefore, there is co-existence of high levels of industrialization and high rates of unemployment.
- It strains the government budget. Expensive infrastructure must be set up for industry to develop, this sometimes necessitates borrowing which increases the indebtedness of the country.
- It leads to environmental degradation; sometimes swamps are reclaimed, forests cut down to give room to industrial growth, extinction of species etc. This under develops the economy since they tend to impose a major negative externality on human society.
- Financially, industrial development results in a wide gap between the rich and poor due to a division of labor and capital. Those who own capital tend to accumulate excessive profits derived from their economic activities, resulting in a high disparity of income and wealth.

- Rapid urbanization brought on by industrial development typically leads to the general deterioration of workers' quality of life and many other problems for society, such as crime, stress, and psychological disorders. Long working hours usually lead to poor nutrition and consumption of quick and low-quality foods, resulting in increased incidences of diseases, such as diabetes, heart attack, and strokes.

10.1.4 Problems faced by the industrial sector in developing nations

The industrial sector faces many challenges as discussed below:

- Difficulty in disposing off industrial waste: The environment laws normally prohibit industrialists from polluting the environment; they find a challenge of where to divert the fumes or pour solid waste.
- A narrow supply of quality raw materials: Most industries in developing countries are agro-based, underdeveloped, and produce poor quality output. This gives rise to poor quality industrial output whose marketability is hard. It sometimes necessitates importing raw materials that makes output too expensive failing to compete on the world market.

- A limited supply of skilled personnel. Developing countries have a limited supply of qualified, skilled, and experienced personnel with industrial skills. This necessitates importing expatriates that increase the price of final goods and services since such people are expensive.
- Under developed infrastructure: Industry requires well-developed road and telecommunication network to develop and a persistent supply of hydroelectric power. Their inadequacy is a great challenge to industrialists as they are forced to produce in excess capacity.
- Limited capital funds: Since most people in developing countries are poor, they do not have adequate funds to expand their industries or even purchase more efficient and advanced machines.
- Heavy taxes levied by government: Governments of developing countries tend to tax industries heavily, this increases their costs of production and sometimes totally fail and close up the industrial plant.
- Competition from abroad: Industrial products from LDCs are normally outcompeted by those from developed nations which are of good quality and low priced because such firms are already enjoying the economies of large scale.
- Political instabilities and unrests from developing countries: Industrialists in developing countries live in fear of having their entire plant destroyed by an insurgency that can erupt anytime in LDCS. Developing countries are politically insecure.
- A small size of the market: People in developing countries are poor, they can not afford the prices of quality industrial output. This forces industrialists to produce in excess capacity.
- Conservatism of the people in developing countries: People in developing countries are rigid; they are not yet free with manufactured industrial goods. Consequently, several of industrial output is wasted if not exported.

Measures taken by the government to achieve industrial development

Industrial development is essential for economic growth since it plays a big role in the growth of the agriculture sector. These act as sister sectors where one provides equipment while the other raw materials. Below are some measures that can be undertaken to achieve industrial development:

- Liberalisation: This involves removing barriers to participating in trade encouraging investors from within and outside the country.
- Reducing procedures that a person follows to open up businesses. This has made the country one of the easiest to invest south of the Sahara and its attracting many investors.
- Investments have been taken by the government itself by the investment authority hence industrialising the country.
- Re-organisation of medium and local small industries into small associations that can act as linkages and expand output.
- Participation fully in regional organisations like EAC has helped the country acquire market and this has increased production and investment.
- Land allocation for industrial estates has enabled the investors to have access for construction.
- Man power training programmes have started in different institutions to train technicians, engineers among others all aimed at providing the skilled personnel needed.
- Credit institutions have been put in place to avail credit to people willing to put up small and medium industries.
- Rehabilitation and construction of major infrastructure in conjunction with communication lines has been done aiming at improving movement and communication.
- Political stability has been undertaken and this has created confidence in the minds of the investors hence increased investments in the different parts of the country.

10.2 Industrial Development Approaches

Industrial development is one of the development goals in Rwanda. However, it is a complex and dynamic process. In Rwanda and developing countries in general, industrial development is even more complicated because it involves the interactions of domestic firms and multinational corporations (MNCs), the role of the government, and the development of technology. Therefore, let us tackle production techniques as one of the approaches any economy can undertake for their industrial development process so as to achieve her goals of economic development. Such approaches may include among others the following;

- Export promotion industrial strategy;
- Import substitution industrial strategy,
- Technology,
- Small scale versus largescale industrial strategy.

10.2.1 Capital intensive technology

Activity 2

Using photos, A and B in figure 2 below, undertake research about Industrial development approaches and through class presentation, share your views about the questions that follow.

Required:

(i) Describe the ratio of people to machines in the photos below.

(ii) What do you understand by the term technology?

(iii) With supporting reasons state the type of technology applied in the activities above.

(iv) What benefits and costs are likely to be faced using the technique mentioned in iii) above during production process.

(v) What do you think limits its use in most industries in Rwanda.

Figure 2: Industrial processes

Facts

Meaning

A technique is any alternative method of production available to produce goods and services. The choice of the technique depends on the following

- Benefit of the technique to the user.
- Efficiency of the technique.
- Prevailing economic conditions in the area or country.
- The cost of the technique.
- The advantages and disadvantages of the technique compared to others.

Capital intensive technique is technique that uses more proportion of machines than other factors of production like labour. It can also be called labour saving technique. Capital-intensive production represents the proportion of capital (machinery, equipment, inventories) relative to labour, measured by the capital–labour ratio. Under this technique of production, there are many machines compared to the number of people, i.e. the capital-labour ratio is very high.

Figure 3: Capital intensive technique

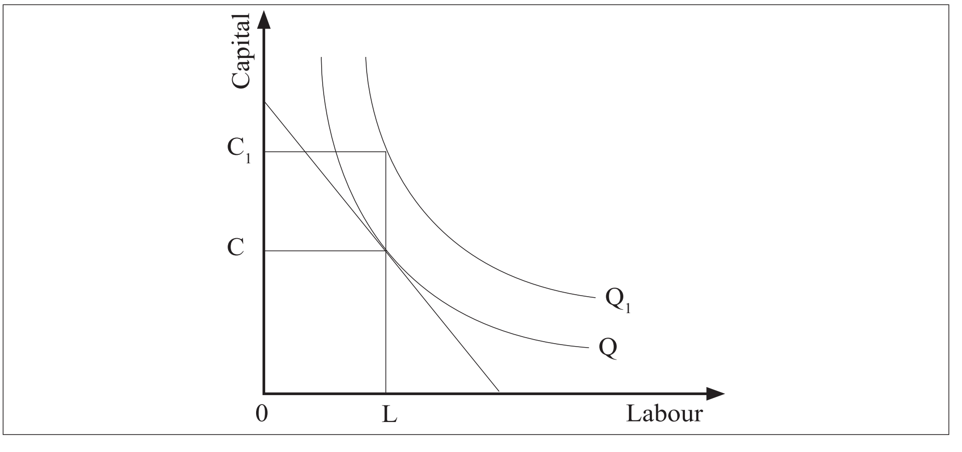


Figure 3 above shows that there is an increase in use of capital from **C** to **C_1**, and this led to an increase in output from **Q** to **Q_1**, while the labour units remain few and constant at **L**.

Advantages of capital intensive technique

Capital intensive technique is important towards the development of the nation because of the following reasons:

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

Disadvantages of capital intensive technique

Despite the advantages, the technique also has its own demerits as shown below:

- The technique leads to technological unemployment: This is because more proportions of machines are used in relation to the labour.
- It is expensive to install and maintain. The machines that are employed are expensive to install and maintain.
- The technique requires skilled manpower which is scarce in low developing countries. This calls for acquisition of imported labour which may lead to profit repatriation.
- There is promotion of capital outflow when buying the machines and repairs. The machines have their repairs bought from outside countries and thus continuous outflow.

- The balance of payment position is worsened when acquiring the machines since they are expensive.
- Income inequality is promoted because of technological unemployment when people are replaced with machines.
- The technique leads to high social costs like wastes/fumes from the machines which may be harmful to the environment and to the people.
- High rates of resource exhaustion: This is because the machines tend to produce a lot since there is no human judgment.
- Dependence on other countries for machines and expatriates may limit the country to be self-reliant.

Facts

The development and use of capital intensive technique of production faces a number of obstacles some of which are discussed below:

- Inadequate capital by the people limits them to acquire the machines hence they resort to labour intensive technique.
- High tax charged on the importation of the machines makes people to shun away from them and they retain labour.
- Inadequate market both internal and external discourages people to use the capital intensive technique since the excess supply will not have market.
- Inadequate raw materials lead to constant importation creating constant balance of payment problems.
- High operation costs due to large scale production affects the operations of the business and it may result into increase in prices.
- Underdeveloped infrastructure like roads limit the movement of the machines and it may affect the development of the technique of production.
- The system requires developed technology which is still lacking in developing countries. Technology is still intermediate low and cannot produce large quantities.

10.2.2 Labour intensive technique

Activity 3

(i) Identify the form of activities in the photos above and the technique used in their production processes. Justify your answer.

(ii) Identify different other activities that use such a technique in Rwanda.

(iii) Examine the contribution of such a technique to the development process of Rwanda.

(iv) What hinders its effective use in Rwanda?

Figure 3: Labour intensive

Facts

Meaning of labour intensive technique

Labour intensive technique is that technique of production that uses more proportion of labour than other factors of production like machines. It is sometimes called capital saving or one-pound technique. The degree of labour intensity is typically measured in proportion to the amount of capital required to produce the goods/services; the higher the proportion of labour costs required, the more labour intensive the business.

Labour costs are considered variable, while capital costs are considered fixed. This gives labour-intensive industries an advantage in controlling expenses during market downturns by controlling the size of the employee base.

Figure 5: Labour intensive technique

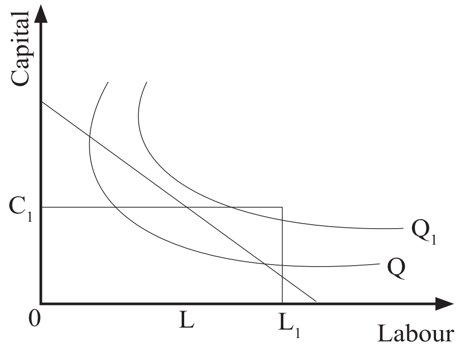


Figure 5 above shows that there is an increase in use of labour units from **L** to $\mathbf{L_1}$, and this led to an increase in output from **Q** to $\mathbf{Q_1}$, while the capital units remain few and constant at **c**.

Advantages of labour intensive technique

Using a large proportion of labour compared to machines is important to the society and economy at large as discussed below:

- Labour intensive is cheap and easily afforded since it uses mostly labour which is cheaper compared to machines.
- It is a source of employment thus reduces the unemployment problem in the country.
- The technique helps in income distribution since the number of the unemployed is low. This technique employs more labour.
- It requires little/ limited skills. The technique may not need complicated skills compared to the capital intensive technique.
- Reduction in social costs such as pollution. The technique does not involve extrusion of fumes on land, water and atmosphere hence it does not degrade the environment.
- Increased employment increases aggregate demand and investment.
- The technique is needed most in agriculture where human judgment is paramount. Some decisions in agriculture cannot be done by machines hence labour is the best option.

- This technique helps to control overexploitation of resources. Production can be controlled when using labour by not using the areas that have been used.
- No need to import expatriates since the technique can be operated by the available labour.

Disadvantages of labour intensive technique

Despite the benefits of using more workers than machines, the technique suffers a number of disadvantages.

- There is low productivity compared to capital intensive technique. This is because the labour cannot do the work as quick as the machines.
- The technique is costly in the long run in terms of feeding, med-care among others and this increases the cost of production compared to when machines are used
- There is production of low quality output because of the low skills possessed by the workers.
- Underutilisation of resources is common since the labour cannot cover big areas during the production process.
- It does not encourage technology development because it uses more labour compared to machines. This further leads to under development.
- Labour unrests and strikes are common when using this method and this leads to production stopping for some time hence no output and earnings.
- It is hard to standardise output using the technique. Labour may not be able to produce good standard output because it may not have a standard measure.

Facts

Despite it having to use more labour than machines, the labour intensive technique has faced numerous obstacles as seen below:

- Inadequate labour due to rural urban migration leaves the industries with no option but to use capital intensive techniques.
- Need to produce good quality output calls for capital intensive technique so as to get output that can compete at the bigger stage in the market.
- Increase in demand calls for increased supply which can only be done by capital intensive techniques.
- Specialisation requires more use of machines since it requires use of expansive land or covers wide industrial areas.
- Production where human judgment is not needed can be easily done by machines compared to labour when the major aim is to maximise output.
- In the long run, it may be costly with the expenditures on medication, housing allowances among others.
- Government policy of standardisation may not be put into consideration by labour intensive techniques but rather capital intensive techniques.

10.2.3 Intermediate technology

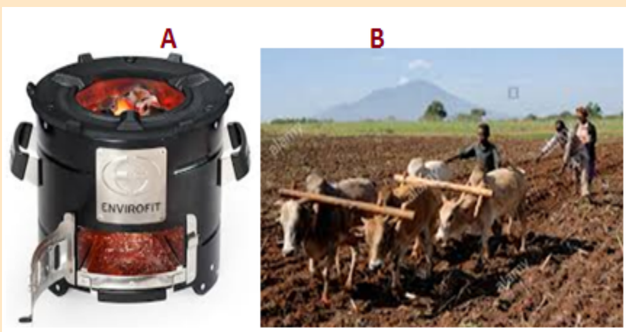
Activity 4

Analyse the Photos below and answer the questions that follow.

Required:

1) Which technique of production is cited in photos A and B above? Give a clear justification.
2) Comparing the images in activity 2, 3 and these ones in activity 4, what marks the difference among the techniques used in production?
3) What are the major distinguishing features of the technique mentioned in a) above?
4) Describe the arguments for and against the use of such a technique in production process and its limitations.
5) What do you think it requires for a country to attain such technique of production?

Figure 4: Techniques of production



Facts

Meaning of intermediate technology

Intermediate technology is the type of technology which is midway between the modern technology and the traditional- primitive technology. Intermediate technology involves, simple and practical tools, basic machines, and engineering systems that economically disadvantaged farmers and other rural people can purchase or construct from resources that are locally available to improve their well-being. Designed to focus on people rather than machines, intermediate technology is considered to be more harmonious with the environment and with traditional ways of life.

Intermediate technology requires a regional approach to development and requires four conditions for its success.

1. Workplaces should be created in areas where the majority of the people live.
2. Workplaces should be cheap so that they can be created in large numbers with little capital.
3. Methods of production should be fairly simple, requiring low skills and suitable for maintenance and repair at the workplace.
4. Production should depend basically on local materials for local use.

Features of intermediate technology

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

Advantages of intermediate technology

Technology that is neither too developed nor too backward has the following advantages:

- The technology used is better than the rudimentary tools. This leads to increased output and hence economic growth.
- It promotes development of skills of the people since it is mid way the developed and primitive methods.
- There is efficient utilisation of resources in an economy since it may not under utilise or over utilise the resources.
- There is increased labour productivity because it uses tools advanced than the traditional ones. In this case, labour is able to exercise it's skills
- It widens the tax base due to increased output which is produced and increases the revenue of the producers.

- More employment opportunities are provided since the technology used is not so advanced and it calls for more use of the idle labour.
- The method saves foreign exchange which would have been used to acquire the modern technology. This also reduces capital outflow.
- The technology encourages rural development. This is because it can be applicable everywhere either urban or rural.

Disadvantages of intermediate technology

Despite being advantageous, it also has disadvantages as seen below:

- Under-utilisation of resources: This is because the technology used may not fully exploit the available resources.
- The system slows down economic growth since the output is low, it may not enable growth to move together with development.
- Starvation may arise when the output produced is not able to satisfy the desires of the society.
- Low quality output is produced and this may not fetch enough foreign exchange for the country.
- It may stagnate the country from acquiring the modern technology by concentrating on the intermediate technology that may be inefficient.
- Development of large scale industries may be at a slow rate because of the intermediate technology which is suitable for small scale industries.
- The technology may create uncertainty in the production process because of the constant break down due to obsoleteness.

Limitations of intermediate technology

The development of intermediate technology is hindered by the following reasons:

- The need to improve output by producers has enabled them to go for the modern technology instead of developing the intermediate one.
- The issue of standardisation calls for technology that can produce good quality output that is able to compete at the world market.
- External foreign influence which brings in the developed technology hinders the development of the intermediate technology in our society.
- Government influence: The government is not doing enough to develop intermediate technology instead its interested in modern technology that quickens development.

- Low Level of funds: The low level of funds has hindered research into techniques that are developed from primitive to semi-modern in the economy.
- Low Level of skills and education: Low education levels and skills have hindered innovation and invention of methods into medium term technology.
- Low Level of innovation and inventions: The low level of innovation has retarded the growth of the technology from the primitive one to the one that is semi developed.

10.2.4 Appropriate technology

Activity 5

Visit the library or the internet, research and share in class about the following;

(i) What do we call a technique of production that is suitable for a country's social economic set up.

(ii) What distinguishing features should such a technique of production have to be regarded as suitable for a given country's social economic setup?

(iii) The advantages of such a technique and what you think hinders countries from achieving its use.

Facts

Meaning of appropriate technology

Appropriate technology is the type of technology which is socially and economically suitable for a given society or country. Appropriate Technology is technology tailored to fit the psychosocial and biophysical context prevailing in a particular location and period.

The appropriate technology for an area depends on its resources and markets. It is an amalgamation of skills, methods of techniques, appliances and equipment that can contribute towards solving the basic socio-economic problems of a particular society. Appropriate technology should not be static but dynamic, changing with the time.

Appropriate technology is the technology that fits the conditions of the society.

Characteristics of appropriate technology

- It should be simple and comparatively cheap.
- It should be manageable by the majority of the people.
- It should make use of local resources.
- It should meet the local needs.
- It should solve the local problems of the country. For instance, it must create employment opportunities; it must solve the problem of income inequality; and it must generate economic growth.
- It should encourage capital formation and stimulate growth.
- It should be ecologically sound and in complete harmony and conformity with local environment.
- It should improve efficiency and productivity.

Advantages of appropriate technology

- It's simple and comparatively cheap compared to intermediate and modern technology and this makes it affordable.
- This technology is manageable by the majority of the people and therefore the people have access to it during the production process.
- It makes use of local resources and therefore reduces importation of raw materials that may lead to foreign exchange outflow.
- It meets the local needs of the people and therefore it is sufficient for them
- It solves the local problems of the country. For instance, it creates employment opportunities; it solves the problem of income inequality; and it must generate economic growth.
- The technology encourages capital formation and stimulates growth through increased production and output.
- It is ecologically sound and in complete harmony and conformity with local environment and this enables it not to over exploit the resources.

Disadvantages of appropriate technology

- If the technology suitable is expensive, it may require large sums of capital which is not readily available in developing countries.
- Low Level of skills and education may not be able to use the modern suitable technology.
- Modern technology requires high levels of innovation and inventions which is lacking in low developing countries.
- It is sometimes difficult to get due to inadequate technology.
- Sometimes the suitable technology may be outdated and thus may produce little output for the economy.

Limitations of appropriate technology

The limitations of appropriate technology development are:

- Low Level of funds: The low level of funds has hindered research into techniques that suit the economy.
- Low Level of skills and education: Low education levels and skills have hindered innovation and invention of methods that suit the economy.
- Low Level of innovation and inventions: The low level of innovation has retarded the growth of the technology from the primitive one to the one appropriate.
- External foreign influence brings in the complicated technology that hinders the development of the one appropriate to our society.
- Government influence: The government is not doing enough to develop appropriate technology instead its interested in modern technology that quickens development.
- Natural factors: These include relief, soils among others and they hinder the movement of the machines to respective areas of production.
- Low Level of entrepreneurship: This is low and hence it has not helped in taking up the risks in technological development.

10.2.5 Technological transfer

Activity 6

Give your views through class discussion on the following issues.

a) Technology transfer has done more harm than good towards development of low developing countries' growth journey".

b) Developing countries have always wished to acquire better technology from developed countries but fail to, what are the hindrances?

Facts

Meaning of technology transfer

Technological transfer is the movement/ shifting of new efficient production techniques from one economy to another mainly from developed economies to developing economies/countries. It can also be defined as the process of transferring skills, knowledge, technologies, methods of manufacturing, samples of manufacturing and facilities from one place or country to another mainly from developed country to developing countries.

Advantages of technology transfer

Technology transfer like industrial growth, is so important to the economy. When the country acquires modern technology it is able to develop faster through increase in quality and quantity. Alongside this, there are many advantages of technology transfer as seen below:

- Technology transfer helps in overcoming backwardness. The transfer of technology from MDCs to LDCs introduces advanced techniques of production, better machines, better products, better organisational and managerial skills as well as skilled personnel.
- It accelerates the rate of economic growth in LDCs. This will consequently reduce poverty, income inequalities and unemployment. Generally, the standard of living will improve. A number of socio-economic problems are solved through technology transfer.

- It increases productivity. The transfer of technology is required for increasing labour and capital productivity.
- It reduces the technology gap. This gap can be reduced through technology transfer from MDCs to LDCs. Technology from MDCs supplements the available traditional technology and helps to modify the existing technologies.
- Technology transfer develops key industries and basic infrastructure. LDCs lack basic industries and infrastructure (e.g. transport, communications, and power). The natural resources of LDCs have either remained unutilised, underutilised or miss-utilised due to lack of technology.
- Exploitation of resources involves high risks. Large capital, long gestation period and modern technology and hence a need for technology transfers.
- It makes products from LDCs more competitive. LDCs mostly export unprocessed products, raw materials and poor quality finished products. These products fetch low prices in the international market.
- It saves time and financial resources. This is because there is no need to undertake research for technology since it is already available in MDCs

Demerits of technology transfer

Despite the importance of technology transfer, it has had disadvantages it brings to the environment and economy:

- echnological dependence: Since LDCs lack skilled personnel and financial resources to undertake research for new technologies, there is technological dependence.
- High costs: MDCs prefer to sell their technologies as a package to projects. The technologies are tied to specific projects. LDCs are forced to buy such technologies along with raw materials, machines, spare parts and foreign personnel at high costs compared to those prevailing in the competitive world market.
- Retardation of the development of local entrepreneurship: Firms from MDCs often transfer new technologies to their own subsidiaries within LDCs. These subsidiaries hardly share new technologies with local firms and as a consequence, these new technologies do not enter other activities of national economies.

- TTax evasion: More than often, foreign firms request for large tax concessions from host countries in the form of tax holiday and repatriation of a large percentage of profits.
- Social tensions: There are large wage differentials between workers in the firms which have transfer technologies and workers engaged in local firms in the LDCs. These wage differentials increase income inequalities thereby causing social tensions.
- Unemployment problem is not solved: MDCs normally transfer capital-intensive technologies which have limited labour absorption capacity. Such technologies have failed to overcome the problem of unemployment in LDCs. At times, such technologies have accelerated the rate of rural-urban migration with all its consequences.
- Out-dated technology: More often than not, MDCs transfer discarded technology to LDCs. This technology though it appears cheap at the time it is being purchased; it may entail high costs in terms of frequent breakdowns and constant repairs. Consequently, LDCs are faced with heavy losses.

Limitations of technology transfer

Facts

Technology transfer is important to economies since it makes growth easier. Because of this, countries tend to demand more of it though this has faced a number of obstacles as seen below:

- Small size of domestic market: The market can hardly support the output that will be produced by the advanced technology.
- Lack of basic infrastructure i.e. transport, energy and a well developed banking system.
- Lack of skilled labour to operate the machines and technology and this will lead to use of foreign expatriates who are expensive.
- Strict foreign exchange controls.
- Political and economic instability: The economic instability affects the use of machines since the output may not have market. Political instability may on the other hand distort the installations of the technology.

- Heavy taxes like the heavy custom duties limit the importers of the technology.
- Some of the technology may not be appropriate and could not use the available resources hence may not be of importance.
- Opposition by the government sometimes may affect the process. This is because the government may desire to develop the local technology.
- Conservatism of the people who may not be in position to absorb and take on the new technology.

10.2.6 Technology development

Activity 7

Analyse the case study below and answer the questions that follow.

There are wide variations between the developing countries in the capabilities of their enterprises to import, utilize and improve upon industrial technologies. It is important for the purposes of industrial policy to understand why these differences exist and how industrial capabilities may be improved. The process of becoming efficient in industry is very different from the usual textbook portrayal, in which firms costlessly access and absorb new technologies. In reality, there is a long and uncertain learning process involved, differing with the nature of the technology, the efficiency of factor and product markets, and the provision of various technological information and services from the infrastructure institutions. There is a widespread risk in developing countries that all these markets suffer from failures: the scope for technology development policies rests on the need to remedy these failures. The experience of the most successful newly industrializing economies (NIEs) suggests that well-designed interventions, both selective and functional, are needed to promote technology development

Experience clearly shows the dangers of government failure, but it is necessary to retain a large role for the government if industry is to succeed. The pattern and implementation of interventions have to be very different.

(iv) From the case study above, what do you understand by the term technological development?

(v) If a country decides to initiate her own technology, present the benefit and costs it is likely to face.

(vi) What limits developing countries to attain technological development as cited in the case study above?

Facts

Meaning of technology development

Technology development refers to the process of introducing and initiating new technology through improving the local/indigenous production techniques. The purpose is for high output and good standards. Developing countries have had their own technology that has been used in the previous decades. With the economies developing through different stages and the increased competition and need for prosperity, countries have had to change their way of life through making an improvement on the techniques of production. With economic integration and international trade, there is need to increase output so as to serve the ever growing market. Countries have had to shift from local to modern technology.

Advantages of technology development

When a country wants to develop, it has to develop its technology so as to quicken work. This is very important because of the following reasons:

- The capital stock in LDCs is very small and their rate of capital formation is very low. The savings are so low that they cannot generate any noticeable capital accumulation. Thus the development of technology helps to reduce capital deficiency.

- Development of infrastructure: LDCs have low developed infrastructures, yet they are necessary for economic development. Since infrastructural development requires large capital investment, such countries are unable to undertake them without technology.
- Technology development helps LDCs in the development of basic and key industries by themselves. It is through foreign capital that LDCs can establish steel, heavy electrical and chemical plants. Thus, technology helps in industrialising the economy.
- Initiation of risky ventures: Private entrepreneurs in LDCs are reluctant to undertake risky ventures, like the exploitation of untapped natural resources. Thus, technology development opens up inaccessible areas, taps new resources, and helps remove regional imbalance.
- Technology development tends to increase employment opportunities. This is generally true in the urban areas. On the other hand, it leads to rural-urban migration.
- Technology development tends to raise the levels of national productivity, income and employment which, in turn, leads to higher real wages for labour; lower prices for consumers and a rise in their standard of living.
- Technology development helps to overcome the balance of payment problem experienced in LDCs. This is true in the long-run when the productivity increases.

Disadvantages of technology development

Though important, its development has had a negative effect to both society and economy as given below:

- High social costs like pollution from the machines and this leads to environmental degradation that may be harmful to the people.
- High rates of resource exhaustion: This is because the machines tend to produce a lot since there is no human judgment.
- Promotes dependence on other countries for machines and expatriates and this may limit the country from being self-reliant.
- Promotes capital outflow when buying the machines and repairs. The machines have their repairs bought from outside countries and thus continuous outflow.

- Worsens the balance of payment position when acquiring the machines since they are expensive.
- Promotes income inequality because it creates technological unemployment when people are replaced with machines.
- Leads to technological unemployment: This is because more proportions of machines are used in relation to the labour.
- Expensive to install and maintain: The machines that are employed are expensive to install and still maintenance is recurring in terms of costs.
- Requires skilled man power which is scarce in low developing countries. This calls for acquisition of imported labour which may lead to profit repatriation.

Limitations of technology development

The development of technology in developing countries Rwanda inclusive has faced many challenge as shown below:

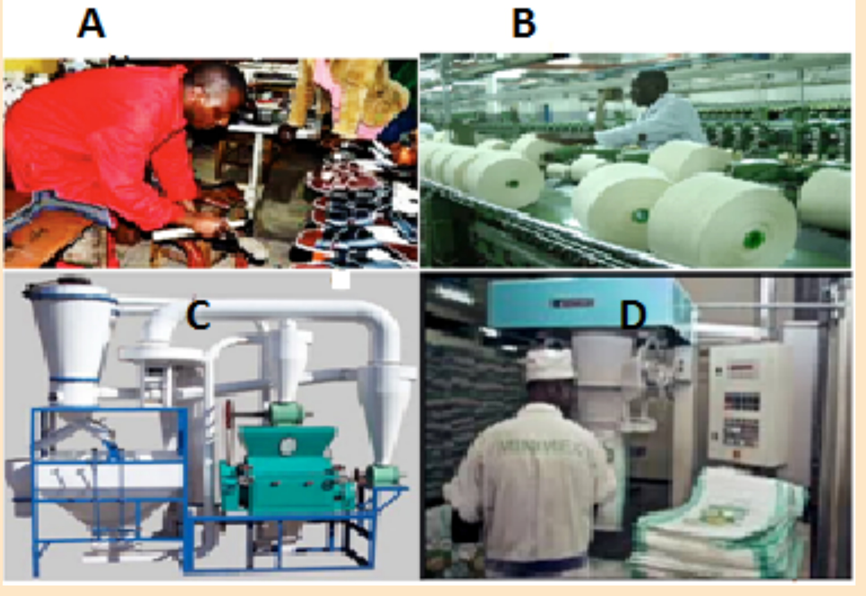
- Inadequate entrepreneurship skills to develop and maintain the technology is still a major obstacle.
- Inadequate capital by the people limits them from acquiring machines hence they resort to labour intensive technique.
- High tax charged on the importation of the machines makes people shun away from them and they retain the labour.
- Inadequate market both internal and external discourages people from embracing technology development since the excess supply will not have the market to use it.
- Inadequate raw materials leads to constant importation creating constant balance of payment problems.
- High operation costs due to large scale production. This affects the operations of the business and it may result into increase in prices.
- Underdeveloped infrastructure like roads limit the movement of the machines which may affect development of technology.

10.2.7 Small scale industries (SSI)

Activity 8

Analyse the photos, A, B. C & D and case study below and answer the questions that follow.

Figure 7: Industrial activities in Rwanda.



Case study

The vision 2020 focused among others on job creation and poverty reduction through strengthening the private sector and the government playing its part in maintaining and strengthening the Small and Medium Enterprises sector. The establishment census confirmed that SMEs have a critical role to play in creating jobs for Rwandans, whereby SMEs comprise approximately 98% of the total businesses and account 41% of all private sector employments. The SME sector, with formal and informal businesses, plays a crucial role in the country's development; It has a potential to lower Rwanda's trade imbalance and generate off farm employment. Strengthening this sector has been highlighted as a successful tool in achieving economic goals; that is why the government has taken the lead in small & medium enterprises' sector development.

Required:

(vii) What is described as small-scale industries?

(viii) Identify some industries in Rwanda which work under such a category.

(ix) What characterizes such described as small-scale industries?

(x) "The SME sector, with formal and informal businesses, plays a crucial role in the country's development". Assess the validity of that statement as stated in the case study above, with reference to Rwanda's small-scale industrial sector.

(xi) Small scale industries require little capital to start; however, they are still limited in developing countries. Why?

Facts

Meaning of small scale industries

There is no universal definition of a small-scale industry and thus the term varies from country to country. The size of an industrial unit may be defined in terms of one of a combination of variables — number of employees; capital used (installed capital); level of output (value added); and energy used.

These industries normally operate on a small scale and have small operating areas though standard is their main objective. They normally operate with little start-up capital and basically are owned by single personnel. Typical examples of these industries include; maize milling industries, bakeries, coffee processing plants among others.

They have the following characteristics:

Characteristics of small scale industries

- Employ few workers since they are labour intensive.
- Normally produce low quantity output.
- Technology used is not so much developed.
- Low quality is produced due to low technology used.
- Startup capital is always low.
- Occupy small working areas.
- They are run by their owners.

Advantages of small scale industries

Facts

Small scale industries are a basis to growth in developing countries since they act as stepping stones to the development of the larger ones. They need small capital to start and technology not so sophisticated like that of large scale industries. Related to the above, they play more roles some of which are listed below:

- Small scale industries can easily tap local skills and savings especially in rural areas. These savings can be used to finance further development.
- Small scale industries are easy and cheap to develop and finance as opposed to the large scale industries. Small scale industries require less capital, energy and skilled labour. Their import requirements are usually small thus serving to minimise on foreign exchange outflow.
- They facilitate decentralisation and diversification of economic activities and stimulate integration of different sectors of the economy. They have both forward and backward linkages.
- Small scale industries can be widely spread throughout the country thus taking jobs to the people and halt rural-urban migration. They provide an alternative employment to people who may not be gainfully employed in agriculture.

- Small scale industries usually offer means of livelihood to weaker sections of the community like women and the handicapped. They produce relatively cheap products within the means of the people.
- The size of the market is small since the majority of the people are poor. The small market can only support small scale industries.
- Small-scale industries provide employment opportunities and so they are likely to solve the problem of unemployment that LDCs are experiencing.
- Small scale industries are more likely to promote a more equal distribution of income than large scale industries. This is mainly because they can be set up in large numbers and many people will be employed.

Disadvantages of small scale industries

Despite the advantages given above, small scale industries too have demerits which have hindered their faster development. These are given below:

- Low output is produced since the industries are working on a small scale compared to the large scale industries.
- Wasteful competition leads to duplication of goods and services and wastage of resources.
- They lead to public revenue instabilities since production cannot be relied upon and also high rate of tax avoidance and evasion.
- They operate at excess capacity due to the small units of capital they possess and this may create shortage at the market.
- They don't enjoy economies of scale thus continue operating at high costs hence increasing the prices so as to cover the costs of production.
- They produce low quality output since most of the times the technology used is low.
- They create disguised unemployment since most of the times the industries are small and may underutilise the services of labour by offering work that may not suit their capacities
- Small-scale industries lead to slow development since they lead use poor or low skills of labour and also technology transfer is low.

Limitations of small scale industries

Small-scale industries with their important role in development are not free of handicaps. They face a number of limitations as discussed below:

- There is lack of entrepreneurial ability: Entrepreneurship is a critical factor in any industrial development. In Rwanda, like in many LDCs, there is lack of entrepreneurship. This is partly due to the education system which is basically theoretical.
- Lack of infrastructure: Inadequate transport and energy facilities. This has led to lack of proper industrial premises.
- Inadequate or lack of foreign exchange to import equipment, spares and raw materials.
- Lack of effective demand: Locally produced products have limited demand because they are generally of poor quality.
- Lack of credit facilities due to collateral required by banks to enable them secure loans.
- They don't enjoy economies of scale due to the little capital they start with.
- Unstable supply of raw materials since they mostly use agricultural products which fluctuate constantly.
- Inadequate spare parts to repair the machines and this make them to operate at excess capacity.
- Lack of serious positive attitude towards local industries. Investments in houses, trade, shops, farms etc. are preferred to real industrial investments. There is need for politicisation of investors about the need to develop the industrial sector as a matter of economic strategy.

10.2.8 Large scale industries

Activity 9

Analyse the photos A, B, C and D in figure 8 below and answer the questions that follow:

Figure 8: Industrial activities in Rwanda.

Required:

i) On what scale are the activities in the industries shown above carried out?

ii) identify other industries in Rwanda that operate under such scale.

iii) What are the distinguishing features of such industries that operate on such a scale?

iv) Assess the contribution of such industries to the development process of Rwanda.

v) Large scale industries are still limited in Rwanda, why?

Facts

Meaning of large scale industries

Large scale industries are industries that operate on large scale and have large capital. They can also be defined as those factories that combine at least three characteristics i.e. use of machinery, employment of wage labour and application of regulatory measures like "factory act or disputes act". Normally these industries occupy a large area and employ a large number of people. Examples in Rwanda include; Inyange industries, Sulfo industries, Nyirangalama industries, Utexrwa, Cimerwa among others. They have the following characteristics:

Characteristics of large scale industries

- They have large capital equipment in form of machinery.
- They operate on large areas.
- Output produced is high.
- Good quality is produced.
- They employ large number of workers i.e. both skilled and unskilled.
- They have large turn over at the end of the year.
- They produce both for local and foreign market.

Advantages of large scale industries

Facts

These large scale industries contribute more to the economy through high revenues, employment and infrastructure development. Their importance can not be ignored as given below:

- Infrastructure development: Infrastructure like buildings and roads among others develop where these industries operate and this leads to the development of the area.
- Creates employment opportunities: This is because the industries are large and require large number of workers to operate the machines as well as doing the casual work.
- Revenue to the government: The industries plus the people working in them are taxed by the government. This increases government revenue needed for development.

- Earning foreign exchange to the country: Some of them produce goods for export hence they are able to earn foreign exchange to the country.
- Technology development: Due to the size and the need to produce large output, the industries tend to develop technology to use. In so doing, it reduces technology dependence.
- They produce a variety for the local people. The industries produce a variety of consumer goods that people need.
- They produce goods that were formerly imported thus save the scarce foreign exchange form the country.
- They produce good quality that helps in uplifting the standard of living of the people and still good quality goods are able to fetch high profits when exported to other countries
- They provide market for the local resources as raw materials. Most of the industries are agro-based hence provide market for agriculture commodities.
- Their existence lead to development of other industries through linkages like the sugar industry may lead to development of the sweet industry.

Disadvantages of large scale industries

Despite their numerous advantages, large scale industries have had different disadvantages that have affected the economy. These are given below.

- They are mostly owned by foreign companies hence profit repatriation and this leaves the country with little earnings.
- There is technological unemployment since they tend to become capital intensive as opposed to labour intensive technology.
- Pollution and environmental degradation occurs since they operate large machines which pollute the environment.
- They require lots of capital to start which may result into constant borrowing and debts that may affect the country during times of development.
- Dis-economies of scale due to over expansion creates increase in the costs of production which in turn may raise the prices.
- Over exploitation of resources may come up leading to resource exhaustion and need to import raw materials.

- Concentration in urban centres leading to rural urban migration with its associated problems like prostitution, slum development among others.
- There is wastage of resources especially when the large output fail to find market.
- They tend to outcompete small scale industries leading to their closure and hence they tend to become monopolies which in turn exploits the people through charging high prices.

Limitations of large scale industries

Facts

Large scale industries are important as discussed above and their development is essential to the economy. Despite their importance and the government's quest to develop them, there has been a variety of obstacles as highlighted below:

- Heavy taxes levied by government: Governments of developing countries tend to tax industries heavily, this increases their costs of production which may lead to failure and closure of the industrial plant.
- Competition from abroad: Industrial products from LDCs are normally outcompeted by those from developed nations which are of good quality and low priced because such firms are already enjoying the economies of large scale.
- Political instabilities and unrests from developing countries: Industrialists in developing countries live in fear of having their entire plant destroyed by an insurgency that can erupt anytime in LDCS. Developing countries are politically insecure.
- A small size of the market: People in developing countries are poor, they can not afford the prices of quality industrial output. This forces industrialists to produce in excess capacity.
- A limited supply of skilled personnel: Developing countries have a limited supply of qualified, skilled, and experienced personnel with industrial skills. This necessitates importing expatriates that increase the price of final goods and services since such people are expensive.

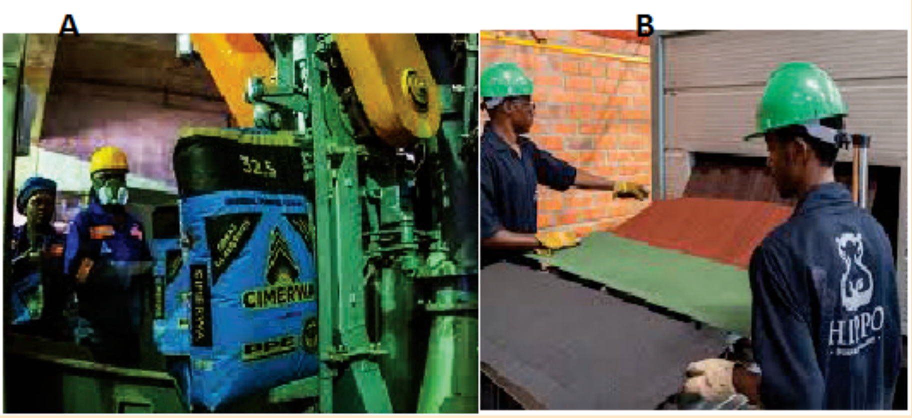
- Under developed infrastructure: Industry requires well-developed road and telecommunication network to develop and a persistent supply of hydroelectric power. Their inadequacy is a great challenge to industrialists as they are forced to produce in excess capacity.
- Limited capital funds: Since most people in developing countries are poor, they do not have adequate funds to expand their industries or even purchase more efficient and advanced machines.
- Difficulty in disposing off industrial waste: The environment laws normally prohibit industrialists from polluting the environment; they find a challenge in finding where to divert the fumes or pour solid waste.
- A narrow supply of quality raw materials: Most industries in developing countries are agro-based, they base on agriculture which is under developed and produces poor quality output. This on several occasions gives rise to poor quality industrial output whose marketability is hard. It sometimes necessitates importing raw materials that makes output too expensive and fails to compete on the world market.

10.2.9 **Import substitution industrial strategy**

Activity 10

Analyse the photos A & B in figure 9 and case study below and answer the questions that follow.

Figure 9: Industrial processes in Rwanda.



Case study:

The government of Rwanda will continue to promote import substitution and diversify exports to cut the exposure to external shocks and imbalances over the medium term. The implementation of Made in Rwanda policy, as the engine of import substitution strategy, will continue to play a key role in narrowing the current account deficit in the short to long run and help to consolidate private sector domestic activities, create jobs and boost economic growth.

Required:

a) Mention the activities done in photos A and B above.

b) What is made in Rwanda policy? Identify some examples of commodities that have been produced ever since the inception of made in Rwanda campaign.

c) Why is the government of Rwanda emphasizing the made in Rwanda campaign?

d) What costs are likely to come with the development of such industries aimed at implementing the made in Rwanda policy.

e) What are the hindrances to the made in Rwanda policy?

Facts

Meaning of import substitution industries

Import substitution strategy is a strategy undertaken by countries to produce goods that were formerly imported so as to reduce the outflow of forex. It can also be called inward looking industrial strategy because it discourages imports and enables the country become self-reliant. This calls for high standard goods to be produced. It is an inward looking strategy that aims at producing what the nation does not have but has a high demand.

Arguments in favour of the strategy

Facts

Import substitution is important to the economy because of the following reasons:

- Infant industries are encouraged to grow since there will no importation from outside and this leads to industrialisation of the nation.
- Employment is created especially when the industries use labour intensive technique of production.
- Economic dependence is reduced because industries produce commodities which were once imported.
- Imported inflation is checked because the country is now able to produce its own goods and no need to import from other countries.
- Tax base of the country is widened since the industries can be taxed and the people also contribute to the revenue of the country.
- Resource utilisation is improved since the industries will need the resources like land, raw materials among others.
- Facilitates industrial development in the country since many industries will be set up.
- Infrastructure like roads and communication lines will be set up to aid communication and movement of goods and services.
- Economic growth comes up because of the persistent increase in the volume of goods and services.

Arguments against import substitution strategy

Despite its importance, the strategy has its weaknesses as shown below:

- Profit repatriation because most of the industries are owned by foreigners so they take back the profits to their mother countries.
- Most industries set up use capital intensive techniques and this leads to technological unemployment.
- The strategy encourages protectionism of the small industries but this leads to inefficiency and poor quality goods.
- Most industries set up produce at very high cost because of shortage of man power, importation of raw materials and this leads to increase in the prices.

- The domestic market may not be enough because the industries produce high rates of output and this leads to price fluctuation.
- The strategy worsens the BOP position of the country because it requires importation of equipment and skilled man power.
- Because of protectionism, the foreign countries may also retaliate by imposing similar tariffs and this will lead to lack of market.
- Over exploitation of resources occurs because of the increased number of industries and this may lead to resource exhaustion.
- The strategy promotes borrowing and dependence because developing countries lack the capital required and this will lead to increased debt burden.

Limitations of import substitution strategy

Since the strategy requires massive investment in infrastructure, it faces the following challenges:

- LDCs have inadequate raw materials to sustain the industries hence they depend on imported raw materials which are expensive.
- Shortage of skilled manpower to work in the industries which leads to using of expensive foreign labour.
- Limited domestic market because of poverty among the people and the high rates of protectionism by the developed countries limits the foreign market.
- Underdeveloped infrastructure like roads limit the transportation of goods to the markets.
- Most LDCs depended on imported capital which results into high maintenance costs because the manpower to carry out the repair is got from outside.
- There is shortage of credit facilities in LDCs from financial institutions to purchase capital equipment.
- Inadequate entrepreneur skills forces LDCs to use foreign labour which is expensive.
- Unfavourable government policies especially over taxing the investors discourage them.
- Political instabilities bring about uncertainties and destruction of the industries already in place.

- High cost unreliable power in LDCs increases the cost of production leading to high prices for the goods and low markets.

10.2.10: Export promotion industrial strategy

Activity 11

Undertake research on export promotion industrial strategy in Rwanda and thereafter, answer the questions that follow.

a) What do you understand by export promotion industrial strategy?

b) Identify examples of industries in Rwanda that aim at increasing the export base.

c) Assess the contribution of export promotion industrial strategy as an alternative policy towards industrial development in Rwanda.

d) What hinders the efficient implementation of the export promotion industrial strategy in Rwanda?

Facts

Meaning of export promotion strategy

Export promotion strategy is a strategy undertaken by the government to set up industries that produce standard goods and services for export so as to increase foreign exchange. It is an outward looking strategy that aims at meeting the international standard of output and aims at producing output that is internationally demanded.

The strategy is credited for having led to the development of the four Asian Tigers (Hong Kong, Singapore, South Korea, and Taiwan) and so can ably help developing countries to prosper.

Argument in favour of export promotion strategy

Facts

Export promotion is important to the economy because of the reasons given below:

- The strategy increases supply of foreign exchange from exports and improves upon the country's balance of payment position.
- It generates more employment opportunities especially when the industries set up use labour intensive techniques of production.
- It encourages resource exploitation and utilisation, such as land and raw materials which are put to full use when industries are set up.
- It widens the tax base of the country since the industries are taxed.
- The strategy creates markets for other sectors because of the many industries creating linkages among themselves e.g. agriculture and industry for raw materials.
- Economic growth will be achieved because of the increased volume of out put.
- There is promotion of the manufacturing sector of the country. The establishment of such industries improves upon the manufacturing sector that is vital for a country's development.
- The strategy encourages production of quality output. The output to be exported must meet international standards, this leads to development.
- It encourages diversification of exports, mainly because the international market is wide and needs different varieties to satisfy it.
- The strategy strengthens international relations; nations improve upon political ties with neighbours and other nations to expand their external market.

Arguments against export promotion strategy

Despite its importance, the strategy has its own weakness as discussed below:

- The strategy encourages dependency on other countries' market rather than self-reliance as a target of development.
- The strategy advocates for production for the external market, it abides by the principles and rules of other nations rather than those at home. The country loses its independence to other nations.

- Shortages may arise locally since all produce is exported for trade. This delays development of the nation.
- The nation is subjected to the stiff international competition; failure to meet the international standard output fails the entire strategy and so losses to the country.
- The commodities from least developed countries are highly priced since their industries are still young and have not started enjoying economies of large scale. They may be out-competed on the international market. This causes total losses to the nation.
- The commercial policies imposed by most developed nations may prefer raw materials from developing nations rather than the manufactured commodities. This causes failure of the strategy.
- Since advertising is expensive, developing countries may fail to advertise their output on the international market; and so fail to get market.

Limitations of export promotion strategy

The strategy is very costly to implement as shown by the limitations below.

- LDCs lack enough raw materials and capital to put up the strategy.
- LDCs produce similar goods therefore the market may be difficult to get among themselves.
- The strategy promotes production for export but this may create shortage at home leading to inflation.
- Protectionism of the developed nations on goods coming from developing nations may further lead to lack of market and low earnings.
- Most of the products for export are of low quality and cannot compete at the world market thus leading to low prices and earnings.
- Political instabilities and insecurity limit the establishment of such industries in the countries.
- LDCs have underdeveloped infrastructure like roads and the banking system among others and this has hindered the development of the strategy.
- MDCs discovered synthetic fibres like nylon, silk among others. They no longer demand for a lot of natural fibres like cotton and this has reduced the market for the local products.

Unit assessment

1. The development of Masoro region in Masaka has got many benefits to the people and economy at large. Examine the benefits talked about above and the factors limiting the activities in the region.
2. Using more machines is more advantageous than using more workers, what advantages are those?
3. (i) Technology development and transfer plays an integral part to the development of an economy. Why is it important to move technology from developed countries to developing countries?
   (ii) What disadvantages does technology transfer have on an economy?
4. Industries that produce on small scale are very import to development of an economy, however in Rwanda, their development is faced with many obstacles. With relevant examples, examine the obstacles faced.

Glossary

- **Appropriate technology**: A type of technology which is socially and economically suitable for a given society or country.
- **Back ward linkages**: This is when an original firm within an industry leads to establishment of another in which the original firm provides market.
- **Capital saving technique**: This is one that uses more proportions of labour than machines. It can be called labour intensive technique.
- **Development strategy**: This is a set of guidelines which a country should follow in formulating and implementing long term policies meant for development.
- **Export promotion industry strategy**: This is a strategy undertaken by the government to set up industries that produce goods and services for export so as to increase foreign exchange. It can also be called outward looking industrial strategy.
- **Forward linkage**: This is when an original firm within an industry leads to establishment of another that uses its products as raw materials.
- **Infant industries**: These are industries which have just started operating and therefore have a small market, low output and high average costs.
- **Import substitution strategy**: This is a strategy undertaken by countries to produce goods that were formerly imported so as to reduce the outflow of forex. It can also be called inward looking industrial strategy.

- **Intermediate technology**: A type of technology which is mid way between the modern technology and the traditional primitive technology.
- **Labour saving technique of production**: A technique that uses more proportions of machines than labour. It is also called capital intensive technique.
- **Technique**: Any alternative method of production available to produce goods and services.
- **Technology transfer**: This is the movement/ shifting of new efficient production techniques from one economy to another mainly from developed economies to developing economies/ countries.
- **Technology development**: This refers to the process of introducing and initiating new technology through improving the local/ indigenous production techniques.

Unit summary

- Industrial development strategy
  - Meaning
  - Merits and demerits
- Approaches to industrial development
  - Capital intensive technology and labour intensive
  - Intermediate and appropriate technology
  - Technological transfer and technology development
  - Small scale and large scale industries
  - Import substitution and export promotion industries

Topic Area 5: Development Economics

Sub-Topic Area 5.2: Development Process and Strategies

UNIT 11

Development Strategies

Key unit competence: Learners will be able to analyse the contribution of development strategies on the economy.

My goals

By the end of this unit, I will be able to:

- Explain the meaning of development strategy.
- Examine the role played by education to the development of the Rwandan economy.
- Suggest the measures for promoting agriculture.
- Explain the types and forms of foreign aid.
- Examine why developing countries need foreign aid.
- Assess the influence of foreign aid to the development of Rwandan economy.
- Explain the problems of relying on foreign aid.
- Describe the different forms of social economic infrastructure.
- Assess the contribution of infrastructure to development of the economy.

11.1 Education and Development

Activity 1

Case study:

Analyse the case study below and answer the questions that follow:

Rwandan's Vision 2020 and its Economic Development and Poverty Reduction Strategy (EDPRS) aim at the development of a knowledge-based and technology-led economy. In this context, Rwanda has embarked on reforms aiming at improving every aspect of quality education. In line with these efforts, the government of Rwanda has focused on aligning curriculum, approached with great awareness and understanding of our actions to the environmental, social and economic dimensions of sustainable development. To this end, education is crucial in the process to achieve sustainable development.

Required:

a) What according to you is meant by education?

b) What type of education does the government of Rwanda offer to its citizens? Give supporting reasons.

c) Why has the government of Rwanda embarked on reforms aiming at improving every aspect of quality education?

d) How has education impacted Rwanda's development path?

e) Examine the problems facing the education sector in Rwanda.

f) In Rwanda, the government implemented policies over the years to ensure there is a high literacy rate among the population. Identify such policies.

11.1.1 Meaning of education

Facts

Education refers to the process of acquiring worthwhile knowledge, skills and values that aid an individual to engage in development activities of his/her country. The knowledge may be technical know how of something, facts of an event, etc. while the skills may be reading, drawing, speaking among others. Values may be love for the environment, socialisation among others. In Rwanda, the education attained caters for both the able children and those with disabilities and it does not discriminate from any sexes.

Education is both formal and informal

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

Informal education is a set of worthwhile knowledge, skills and values obtained from outside the formal set up, that is it can be got from anywhere, anyone especially an adult can be an instructor and there is no organised curriculum, anything can be taught anytime.

11.1.2 Education as an investment

Education is an investment because:

- It is an accumulation of skills just like investments accumulate capital needed to carry out business.
- Education is expensive and costs money just like any other investment asset. This is usually to help in the running of the business.
- Education takes time to yield returns just like any other investment. This is normally after graduation as regards education and setting structure for investments.
- It has an opportunity cost. It involves current sacrifice to come up with results. To achieve education something has to be foregone.

11.1.3 Education as consumption

Education is referred to as consumption because:

- It enables people to enjoy direct utility, elites acquire such titles as professor, doctor, engineer among others which they enjoy when addressed.
- Education enables people to enjoy a wide range of commodities like news papers, magazines which uneducated people cannot consume.
- With education, people share cultures and enjoy experiencing them.

Expenditure on education and health can be regarded as an investment because of the following reasons:

- There are returns in future after studying and also the health improves.
- It involves opportunity cost i.e. foregoing something to attain education and treatment.
- It involves risks i.e. you may not gain from it when you fail to get employment.
- It is costly to acquire because it involves expenditures on fees, scholastic materials and treatment.
- It is scarce i.e. not everyone has access to it like all investments are.
- It provides satisfaction to an individual through utility maximisation.

Need for Education/Positive roles of education

Facts

Education is important towards the development of an economy as discussed in the reasons below:

- It increases technological knowledge of labour and this can help in skill development necessary for economic development.
- Education encourages innovation and invention which may lead to development of technology in the country.
- It encourages people to acquire good standards of living. This is because the people get exposed to different ways of life.
- Education breaks cultural rigidities since people have knowledge about the outside world hence they can implement what they study about the outside world.

- It saves foreign exchange spent on expatriates since the country is able to produce its own citizens that can do the work of the expatriates.
- It reduces the subsistence sector since the educated will be in search for money therefore they will engage in commercialised agriculture.
- Education widens the tax base since it provides employment to the people after studying and still in the education sector employment opportunities are created.
- It may lead to reduction in the population growth rate since the educated are knowledgeable about the control measures and the dangers of population explosion.

Negative roles of education

Despite the importance, education also has some disadvantages as shown below:

- Education may cause balance of payment problem because the educated tend to copy and buy expensive things from abroad (high rates of demonstration).
- It may cause unemployment especially theoretical education which produces job seekers than job creators.
- Education causes rural urban migration as the educated seek better opportunities in the urban centres. Excess migrations lead to open urban unemployment.
- There is social discrimination among the educated and the uneducated as the educated see themselves as superior.
- Education accelerates income inequality since the educated will acquire better paying jobs than the uneducated.
- It may lead to brain drain in search for employment opportunities abroad after failing to get employment home.

11.1.4 Problems faced by education sector in developing countries

The education sector is one of the most important sectors because of the skills it impacts in the citizens. However its development is faced by many challenges as shown below:

- There is limited motivation of teachers: Teachers are under paid and this keeps their morale down hence bringing up half-baked products.
- There are limited skilled and specialised personnel at all levels. Most qualified instructors move to other sectors and even abroad where they can have better remuneration.
- There are limited teaching/learning materials, most of the subjects are theoretically taught, and this keeps the education sector backward.
- The education curriculum in developing countries is still colonial based. Most of the subjects taught and their content is no longer relevant, they train learners for white collar jobs, they make more job seekers than job creators. This accounts for the rampant unemployment in the country.
- There is high school drop-outs especially among the females because of different reasons leads to lack of clients in the institutions.
- Poverty among the people makes them not able to send their children to school or even buy for them scholastic materials.
- There is lack of enough funds for the education sector. This leaves some areas and schools in the rural areas lack equipment to use hence hindering the development.
- Desire for quick money makes children abandon school and this hinders the countries' major objective of education for all.
- Some parents prefer to educate boys compared to girls and this has accelerated gender inequality and income inequality among the males and females.

11.1.5 Measures of promoting education

The need for development of the education sector necessitates the following measures:

- Changing the curriculum from knowledge based to competence based so as to develop a child with all other values other than knowledge only.
- Promoting vocational education so as to produce students that have practical skills and can start their own businesses instead of waiting for employment, i.e. job creators rather than seekers.
- Increasing the motivation of the teachers so that they can carry out their activities genuinely and professionally.
- Cost sharing should be encouraged so as to avoid school drop-outs. Here the governments can undertake paying part of the students' tuition and the students pay a smaller part.
- Policies for girl child have been embarked on through reducing their entry points at the higher institutions of learning and also when recruiting for secondary schools. Organisations such as Imbuto Foundation in Rwanda has had a major impact in girl child education.
- Active participation of the private sector in the education system through taking up government educational programmes as well as setting up new schools at affordable fees structures.
- Universal primary education and secondary education has been actively emphasised and this has helped to educate the low income earners and the poor.
- Educational loans to help the students at higher levels. This is common in Rwanda under the government fees/ tuition structure where the students in the higher institutions are given educational loans and they pay back in instalments upon completion of the studies when they get jobs.

11.2 Foreign Aid and Economic Development

Activity 2

Analyse the photos A, B, C & D and statement below, and answer the questions that follow.

Figure 1: Aid items

"It is better to face things the hard way and go straight to the heart of any problem. An example, is something we have been talking about for a long time, the issue of relying on others to pay for things that benefit us. It is really a question of dignity, our 'agaciro'. ……… we should resolve to set a deadline, which should come sooner rather than later, after which Rwanda will no longer be waiting for what others hand out to us."

Required:

Basing on the photos A, B, C & D and the statement above;

(i) State the major theme of concern depicted in there.

(ii) Classify each photo with regard to the answer mentioned in 'a' above.

(iii) Why do some countries request for such items as seen in the photos A, B, C&D form others?

(iv) Most developed countries like giving a hand in solving developing countries' issues. Why do you think they do?

(v) Explain the adverse effect of over relying on such and more other items to the recipient countries.

(vi) It is really a question of dignity, our 'agaciro'. With reference to the statement above, why do you think the government of Rwanda emphasizes the issue of "our agaciro"?

(vii) Some developed countries are hesitant to extend aid to some developing countries, why do you think are?

11.2.1 Meaning of foreign aid

Facts

Foreign aid is the international transfer of resources either on loan or grant from one country to another. It can also be defined as any form of assistance given by one country to another so as to achieve its intended objective. Normally this assistance comes from developed countries which have many resources and flows to developing countries. This aid can either be economic, technical, military among others.

Features of foreign aid

- It is often tied meaning that it is given for a specific activity.
- It is associated with high interest rates.
- It is politically influenced i.e. most aid is normally got from former colonial masters.
- It is normally given in small quantities.
- It tends to be irregular etc.

11.2.2 Forms of foreign aid

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

- **Bilateral aid**: This is a government to government aid. One country giving aid to the other, major bilateral donors are; Great Britain, U.S.A, China.

11.2.3 Need for foreign aid

Developing countries need foreign aid because of many reasons as explained below:

- Foreign aid increases a country's resources and this helps it to meet its deficits especially in the national budget.
- Foreign aid helps a nation to alleviate the effects of catastrophes. Calamities like famine, landslides earth quakes and floods normally render nations helpless, foreign aid helps them regain their stand.
- Foreign aid closes the manpower gap which is prevalent in developing countries. The skilled manpower that is inadequate in LDCs alongside its need is covered by the manpower aid from developed nations.
- Foreign aid improves technology in developing countries; aid in form of machines and other equipment improves quality of output and production methods thus developing LDCs.
- Foreign aid provides employment opportunities to people in LDCS. Directly investment aid employs people of developing countries and indirectly to people who construct the investment.
- Foreign aid closes the foreign exchange gap in developing countries. Financial aid extended to LDCs is in form of foreign currencies, this increases the foreign exchange reserves in developing countries hence developing them.
- Foreign aid strengthens international relations. Developing countries tend to keep good political ties with others to as so easily help them in times of need.

Facts

Reasons for giving aid

There are many motives that encourage developed countries to give aid to developing nations. Some of these are explained as follows:

- To get more commercial gains: Aid in form of multinational companies is profit motivated. It is sent to developing nations to earn them more profits.
- To alleviate the effects of catastrophes: Aid is sent to nations to help them out of the effects of such unprepared natural occurrences like el-ninoes, earth quakes and floods.
- To control valuable natural resources in the recipients: Donors give aid to gain full control of the valuable resources in recipient nations like gold, diamond, oil.
- To have military superiority: Military aid is given to control the military set up of all nations. Normally the knowledge to make ammunitions is not sent and recipients are given weaker ammunitions as the donor retains the strong ones. This helps them to be military super powers.
- To dispose-off their outdated machines and obsolete technology and fashions that was not bought in time.
- To create a dumping ground for their poorly manufactured commodities and other surpluses.
- To extend political influence to the recipients. It's a form of neo colonialism.
- In the early days it was to extend ideology to other nations, ideologies like capitalism and socialism were extended to other nations through giving them aid.

11.2.4 Problems of relying on foreign aid

Despite the importance of foreign aid, overdependence on aid comes with a number of repercussions as shown below:

- It worsens the debt servicing problem. Loans contracted must be paid back and on several occasions with interest, this drains the national resources thus denying nationals essentials.
- There is high balance of payment deficit. The high out flow of resources to pay back loans and service them worsens the balance of payment position of the country.

- Sometimes the technological aid given is inappropriate. It may be too underdeveloped or beyond the standards of developing countries, so it may just be wasted.
- Sometimes the pre-conditions set for foreign aid are disastrous for a country. Countries may be forced to devalue their currency, retrench workers or even accept behaviour that is considered anti social some times e.g accepting gay practices in order to receive their aid.
- Tied foreign aid is sometimes tied to unproductive projects like digging boreholes in rural areas, financing wars. This brings difficulty in paying back since such projects do not bring monetary returns.
- The political strings tied to the aid send ruins to the country's independence. Sometimes nations are forced to vote democratically for what they are not ready for or even change leaders.
- Foreign aid slows down initiative and hard work. Citizens of developing countries become lazy expecting to live on aid.
- Foreign aid erodes the social and cultural values of the nationals. They tend to adopt the cultures of the donor whom they normally take as their role model.
- Foreign aid distorts planning of developing countries. This is because it normally comes in bits and normally it's not completed or even sent as promised.
- Foreign aid reduces local production as people expect to live on foreign sent goods. This retards economic growth of nations.

11.2.5 Utilisation of aid

- Import substitution. Countries should utilise foreign aid to develop import substitution strategies rather than targeting only export oriented industries. Sectors like education, agriculture should have more injections in form of foreign aid so as to improve their efficiency.
- Foreign aid should be used to develop skills, technology and enterprises that can help create employment and this will increase productivity and national income in the economy.
- Foreign aid should build the internal capacity and lead to self-reliance and economic development of the country so as to reduce the issues of dependency.

- Foreign aid should be used in projects that pay back such that during the times of paying back, the returns can be used. This will help to reduce the burden of paying back passed to the people through taxation.
- LDCs should always seek for aid that they can use at their will. The aid should be used to carry out projects that the countries think can be of help to them and not what the donors think would be the ideal projects.
- Part of the aid should be used to pay back the already mature debts that may have been got in the previous regimes. This will help reduce the debt burden in the long run.
- The aid should as well be used to help the people who may be languishing in poor standards of living as well as in poverty stricken areas so that the country can have wholesome development and not partial development.

11.2.7 Why donor countries are reluctant to give aid

- The failure of some recipients to effectively use the aid extended to them. This is because some countries misuse the aid. **Note: Absorptive capacity refers to the ability of the recipient country to use the aid extended to them effectively and efficiently.**
- The non-democratic and inhuman records of some governments in developing countries prevent donors from financing them.
- Failure of some developing countries to honour the debt obligations contracted also scare other donors/ lenders from lending them more.
- Threats of nationalising assets owned by foreigners. Some leaders threaten to confiscate and others continue and confiscate assets built by foreigners. These scare other foreigners from investing in developing countries as an investment aid.
- Failure of developing countries to fulfil the IMF conditionalities like demobilisation of the army, currency reforms, privatisation among others. These are ignored by developing countries making donors reluctant to give aid.
- The political climate in developing countries has not been favourable. Donors fear that the politics of developing countries can worsen anytime and they are not certain of the mode of repayment during that state.

11.3 Infrastructure and Economic Development

Activity 3

Analyze the photos A, B, C & D below and answer the questions that follow.

Figure 1: Structural facilities in Rwanda.

Required:

(i) Identify what each of the above photos represent.

(ii) What general economic term is given to the above facilities collectively?

(iii) With reference to the answer got in ii) above, identify other examples in Rwanda that fall under such category.

(iv) Discuss how such facilities have aided the growth and development process of Rwanda's economy.

11.3.1 Meaning of infrastructure

Facts

Infrastructure can broadly be defined as long-term physical assets that operate in economies and enable the provision of goods and services that are geared towards development of the country.

Social Infrastructure is a subset of the infrastructure sector and typically includes assets that accommodate social services. It can also be defined as a combination of basic facilities which are necessary for human development. Examples of social infrastructure assets include schools, universities, hospitals, prisons and community housing.

Economic infrastructure on the other hand refer to internal facilities of a country that make business activity possible, such as communication, transportation, and distribution networks, financial institutions and markets, and energy supply. It can also be defined as a combination of basic facilities which is helpful in economic development of an economy and businesses.

It can be seen that social infrastructure is very important because they lay ground for the economic infrastructure. Both of these infrastructures are complementary to each other and are necessary for the overall development of an economy.

The examples of social infrastructure in different sectors can be seen in the table following.

Table 1: Examples of Social Infrastructure Assets

Sector	Examples
Health	• Medical facilities • Ancillary infrastructure e.g offices, car parks, training facilities
Education	• Schools i.e. primary and secondary • Tertiary facilities • Residential student accommodation
Housing	• State or council housing • Defense force housing

Civil and utilities	• Community and sport facilities • Local government facilities • Water and waste water treatment
Transport	• Roads • Airports
Corrections and justice	• Prison

Table 1 above shows examples of infrastructure

11.3.2 Role of infrastructure in economic development

Economic infrastructure has played a significant role in the growth performance of countries in recent times. Where development of economic infrastructures has followed a rational, well - coordinated and harmonised path, growth and development has received a big boost.

- It provides services that are part of the consumption bundle of residents.
- Large - scale expenditures for public works increase aggregate demand and provide short- run stimulus to the economy.
- It serves as an input into private sector production, thus augmenting output and productivity.
- Education is a very important source of economic growth as the *Denison study shows*. Even though education may be a social investment, it is also an economic investment since it enhances the stock of human capital.
- Health, like education, is a very important argument in the socio-economic production function. A popular saying is that a healthy mind usually resides in a healthy body. Health is one of the major determinants of labour productivity and efficiency.
- Investment in infrastructure is often considered as one of the most effective tools for fighting poverty.
- Access to infrastructure is essential for improving economic opportunities and decreasing inequality. For example, adequate transportation networks in developing countries could give the poor better access to schools, hospitals, and centres of commerce, which in turn would improve the education, health, and entrepreneurial opportunities that strengthen a country's economic potential.

- Housing enables people to have peace of mind and thus also improves their standards of living and livelihoods.
- Sport facilities are used for co-curricular activities that enable one to have a disease free body. A healthy mind lives in health body, as the saying goes. These facilities improve on the life expectancy of the people.
- Prisons as part of correction centres and the justice help to educate and bring right the people who may have created offences. They also educate the prisoners and they come out changed.
- Bus stations, car parks, rides and communication centres help to connect people through transit. They aid in communication and linking of the people to other areas.

Unit assessment

1. Acquiring knowledge and skills is fundamental in development of any human mind. How is it important to the development of the economy in Rwanda? Are there problems that have affected the above process in Rwanda?
2. "Acquiring foreign aid in Rwanda has been more of a curse than a blessing" discuss the above assertion.
3. Explain why countries find it beneficial to give assistance to other countries than receive from them.
4. "Without infrastructure in a country like Rwanda, there is no development" support this statement.

Glossary

- **Bilateral aid**: A government to government aid. A country giving aid to the other. Major bilateral donors are; Great Britain, U.S.A, China.
- **Direct foreign investment**: These are resource transfers by foreign business people in form of business companies or investments.
- **Education**: The process of acquiring worthwhile knowledge, skills and values that aid an individual to engage in development activities of his/her country.
- **Economic infrastructure**: Internal facilities of a country that make business activity possible, such as communication, transportation, and distribution networks, financial institutions and markets, and energy supply.
- **Formal education**: A set of worthwhile knowledge, skills and values obtained from organised institutions, monitored by qualified personnel and following a well-made curriculum.
- **Foreign aid**: An international transfer of resources either on loan or grant from one country to another.
- **Grants**: Resource transfers that do not require any repayment.
- **Hard loan**: A loan that attracts a high interest rate, a very short or no grace period and a very short repayment period.
- **Informal education**: A set of worthwhile knowledge, skills and values obtained from outside the formal set up. Knowledge, skills and values can be got from anywhere, anyone especially an adult can be an instructor and there is no organised curriculum. Anything can be studied anytime.
- **Infrastructure**: This can be broadly defined as long-term physical assets that operate in economics and enable the provision of

goods and services that are geared towards development of the country.

- **Loans**: These are resource transfers which must be paid back with or without interest.
- **Manpower aid**: These are resource transfers to developing countries in form of high level qualified personnel like teachers, economists, technicians, doctors, researchers etc.
- **Medical aid**: This is extended to developing countries in form of drugs, medical research, and construction of health centres to improve upon the health of people.
- **Multilateral aid**: This is aid from multilateral companies and international agencies. Major multilateral donors are; USAID, UN, I.M.F, world bank among others.
- **Soft loans**: These are given with a long grace period, long repayment period and a very low or no interest at all.
- **Social Infrastructure**: A combination of basic facilities which are necessary for human development.
- **Tied aid**: Aid extended to the recipient country with strings attached. It is sent to serve a specified purse and sometimes in a specified place.

Unit summary

- Education and development
    - Education as an investment and consumer good
    - Need for education
    - Role, challenges and measures of promoting education in Rwanda
- Foreign aid and development
    - Meaning and types
    - Role and problems of foreign aid
- Infrastructure and foreign aid
    - Meaning and types
    - Role of infrastructure to development

Topic Area 5: Development Economics

Sub-Topic Area 5.3: Economic Development Planning

UNIT 12

Planning

Key unit competence: Learners will be able to analyse the need for economic planning in an economy.

My goals

By the end of this unit, I will be able to:

- Explain the meaning and rationale of economic development planning.
- Analyse the principles, qualities and obstacles to planning.
- Explain the advantages and disadvantages of partial, comprehensive, short term, and perspective plans.
- Explain the pillars, crosscutting issues, objectives and challenges of vision 2020.
- Analyse the strategies, achievements and challenges of the EDPRS.

Activity 1

Case study 1

Two provinces Kigali and eastern carried out their planning following the national plan by the central government. The source of the funds would be from the central government and foreign aid. Kigali planned to develop all sectors i.e. education, agriculture, industry and infrastructure but this was to be achieved in the long run. Eastern province planned to develop agriculture and infrastructure first then others would come later and this was to be achieved in the short run. There were various reasons why these plans were carried out. During the process, there were many problems faced when implementing the plans. Kigali city failed to accomplish some projects within the stated time while eastern province left some sectors completely under developed. This led to the need to revise the plans prepared by the two provinces

Activity 1:

Basing on the case study above, discuss the following questions

(i) What do you understand by the term development planning? And what makes a good development plan?

(ii) What was supposed to be in place for the success of the planning process by the two provinces?

(iii) Why do you think there was need for planning by the two provinces above?

12.1 Meaning of Development Planning

Facts

Development planning refers to the deliberate government action to influence and direct economic resources towards specific desirable political, social, and economic objectives.

Development planning is making major economic decisions in a conscious way by the determinant authority basing on a comprehensive set up of the economy.

Development planning focuses on capital development, manpower development, infrastructural development, and social services improvement like health and education, all these are coordinated towards attainment of specific desirable variables in an economy like reduction in dependency, fighting the unemployment problem, attainment of a mild rate of inflation, and eradication of illiteracy.

There is a simple distinction between development planning and economic development planning. The former aims at attainment of desired political, social, and economic targets while the latter aims at attainment of only economic objectives.

12.1.1 Characteristics of a good development plan

A good plan is characterised by the following:

1. It should be as comprehensive as possible. It should cover practically all the sectors of the economy. It should cover both the rural and urban areas.
2. It should combine top-down and bottom-up planning approaches through an intensive dialogue between the national, sectoral and local development agencies between the various levels of planning — national, sectoral, district and lower local governments.
3. A development plan should be socially relevant, and it must involve the people in a development effort.
4. A development plan must be economically feasible. The resources to implement the plan must be available.
5. A development plan must be politically and administratively possible. It must be accepted by politicians otherwise it might never be implemented.

12.1.2 Pre-requisites/ conditions necessary for successful planning

The following conditions are necessary for successful planning:

- Planning machinery should be organised and subdivided into small departments dealing with various aspects of the economy like economists, statisticians, engineers, etc. for proper coordination.
- The objectives and goals of the plan should be well spelt out and should be in the interest and of the majority of the society.

- The stated objectives should be consistent and on sectoral basis so as to balance growth in the economy.
- There should be a strong, efficient and incorruptible administration.
- There is need for political stability because instability and insecurity may lead to diversion of all funds which would have been used to finance the plans.
- Public cooperation is also important because the local people also give support when implementing the plan.
- Enough capital should be available for plan formulation and implementation.

Facts

Planning is of importance to the economy because of the following reasons:

- For optimum allocation of resources in the economy so as to eliminate imbalances in resource allocation.
- To help the economy in mobilising funds from international organisations since they give funds according to the plans made.
- To help reduce price instabilities and attain a favourable balance of payment equilibrium.
- To eradicate the defects of price mechanism; the automatic forces of demand and supply sometimes show weaknesses in efficiently allocating resources in an economy; these weaknesses are ironed out by development planning.
- Plans are needed to bring up a balance between the private and the public sector, plans show the relative importance of each sector and so appropriate measures are taken to support the more desired sector.
- To attain a higher level of economic growth and development, plans are made to set up the required infrastructure to attain and increase the rate of economic growth and development.
- Plans are a pre-requisite for getting foreign assistance. Developing countries persistently draw deficit budgets, the deficit is to be obtained from donors, and these require well-made plans to release resources.
- To reduce dependence on other nations, plans are drawn for developing countries to move away from dependence to self-sustenance.

- To fight hyper rated inflation; developing nations draw plans to devise means to moderate the rate of inflation and attain economic stability.
- To eradicate the unemployment problem; this is so rampant in developing countries.

12.1.4 Principles of economic development planning

The planning mechanism must adhere to certain principles in order to be successful, among these include the following:

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

12.1.5 The planning process

Activity 2

With reference to case study 1 in activity1, undertake library or internet research and share your views about the following.

(i) Describe how you think the two provinces might have planned from the start to the end.

(ii) Identify the sources of funds for the planning process from the case study, and state other possible sources the two provinces would acquire funds from.

(iii) Discuss the factors that might have hindered the success of the two provinces' economic plans..

Facts

Figure 2: Planning process

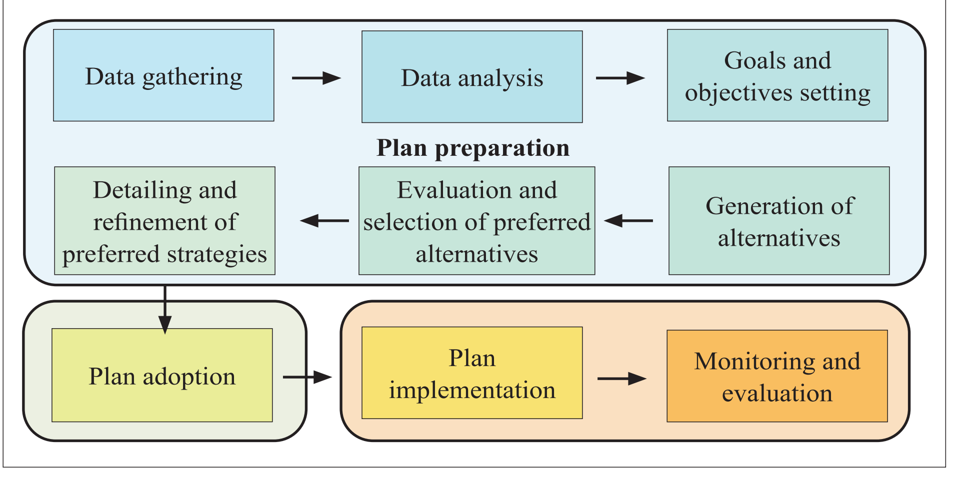


Figure 2 above shows the stages through which the plans go up to their implementations

Development planning has got three major phases which are further divided into other smaller sub phases and these include the following:

1. Plan preparation: this includes the following sub phases.

   (a) Data gathering: This involves collecting data on specific guidelines meant to be developed into plans.

(b) Data analysis: This involves sorting and analysing data to ensure that it involves all what is needed to develop the plan.
(c) Goals and objective setting: This involves setting what is to be achieved in the near future when the plan is implemented.
(d) Generation of alternatives: This involves seeking out other alternatives to the plan that may be developed. It may be different objectives, sources of income, plans among others.
(e) Evaluation and selection of preferred alternatives: This involves selecting what alternative or plan that is to be implemented.
(f) Detailing and refinement of preferred strategies: This involves making the plan or the alternative more detailed so as to be understood by the people.

2. Plan adoption: This is when the plan is accepted and taken on so as to be implemented, this includes:
   (a) Plan adoption: This involves accepting the plan which is on paper as the one that is going to be implemented.
3. Plan implementation: This includes the following
   (a) Plan implementation; this involves putting the plan that has been laid on paper on the ground for action to achieve the intended objective.
   (b) Plan evaluation; this involves checking whether what was planned is what has been implemented on ground.

12.1.6 Ways of financing development plans

Development plans are financed through different ways some of which are seen below:

- Through public borrowing which may be internal from local people or external from countries or organisations like IMF.
- Through deficit financing where planned expenditures are more than estimated earnings with intentions of sourcing out for aid.
- Through taxation to raise revenue. These may be both direct and indirect and also reducing the grace periods given to investors with an aim of increasing tax base.
- Acquiring long term loans from the foreign donors that can have low interest rates.
- Relaying on local savings from government owned enterprises.

- Use of ploughed back profits from government organisations.
- Aid and donations from wealth developed countries.

12.1.7 Obstacles faced in formulation and implementation of development plans

Plan formulation and implementation has faced many challenges in order to be achieved. Some of these are shown below:

- Over ambitious plans: Most of the plans try to achieve many objectives at once and in the end they fail to accomplish them.
- Insufficient and unreliable data: Data in some countries is difficult to get and sometimes unreliable and this makes planning difficult.
- Unexpected social and economic disturbances: These may be internal such as agricultural hazards like pests or external instabilities all making the planning and implementation difficult.
- Institutional weaknesses: The planning machinery may be separated from day to day decision making inadequate communication about the goals and objectives may hinder implementation.
- Lack of political will: Most people lack commitment and a sense of nationalism which hinders the national planning system of the country.
- Inadequate resources: Plans always remain on paper because of failure to mobilise resources both from within and out side.
- Inadequate qualified manpower: Most developing countries lack qualified man power and most of their plans are made by outsiders who have little knowledge about the economic situations in these countries.
- Political instabilities and constant change of governments: These affect the already made plans because each new government has got its own plan for development. Still, the funds which would be for plan implementation are directed towards buying military hardware.
- Poor sequencing: In LDCs, there is lack of funds to put up micro/ small projects which can lead to bigger plans. This leads to failure of the bigger plans.
- Corruption and embezzlement: Most plans have failed because of high levels of corruption in which most of the funds are directed to peoples' selfish interest.
- Political opposition: Some plans fail because of opposition from leaders not part of the government.

12.2 Classification of Plans

Activity 3

Do library or internet search on classification of economic plans and thereafter, respond to the following in class;

a) Describe the different classifications of economic plans that can be adopted by different economies.

b) With reference to the case study in activity 1, and with a clear justification, what form of planning was done by Kigali city and Eastern province respectively? Do you think this form of planning is good or bad? Justify.

c) Discuss the view that Rwanda should adopt a partial plan rather than a comprehensive one for her faster economic growth and development.

d) Centralized and decentralized planning, which is the most ideal planning mechanism that tackles economic issues in an economy efficiently? Justify your answer.

e) Match the following with their correspondences.

(a) Capitalist plan	1. for individual sectors like agriculture
(b) Medium term	2. integrates all activities within the region
(c) Sectoral plan	3. are made in favour of private investors
(d) Regional plan	4. cover between 3-10years.

Facts

Plans are classified according to the following.

12.2.1 Classification according to time element

(a) **Annual/ short term plan**: These are plans which cover a short term period of time usually a year.

(b) **Medium term plans**: These are plans which cover between 3-10 years.

(c) **Perspective/ long term plans/ development plans**: These are plans which cover more than 25 years and have got long term objectives intended to bring about development in the economy.

12.2.2 Classification by implementation

(a) **Indicative plan**: This is a plan prepared by the government and it provides information to the private sector without influencing their decisions directly.

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

12.2.3 Classification according to social- economic system

(a) **Capitalist plan**: This is a type of planning within market economies where the allocation of resources is directed towards the private sector to bring about development. Decisions taken and policies made are in favour of private investors who influence the economic activities in the nation.

(b) **Socialist plan**: This is a plan not based on market mechanism but by the government which owns and allocates resources by administrative directives.

12.2.4 Classification according to hierarchy of planning

(a) **Project plan**: This is a plan undertaken by agencies like parastatals, farmers where by output is produced taking into account the resources available.

(b) **Sectoral plan**: This is a plan for individual sectors like agriculture, industry and such a plan can be made as part of the national plan by the relevant ministries.

(c) **National economic plan**: This is a plan for the whole nation which has to be consistent with the national resources.

(d) **Regional plan**: This is a plan which integrates all activities, programmes and projects within the region aimed at attaining national objectives.

12.2.5 Classification according to coverage

Facts

a) *Partial plan/fragmentary plan/micro plan.*

These are plans drawn to cover only part of the economy. It may be only a region (regional plan), it may be drawn for just a sector (sectoral plan), or for just a project making a project plan.

Advantages of partial planning

- It is cheap and easy to administer because it economises the use of skilled man power which is a problem in LDCs.
- It allows planners to concentrate on a few vital sectors which they can develop successfully and achieve economic growth.
- It develops skills of planners which they can use to take more comprehensive plans.
- It is easy for implementation; because its in the financial reach of the country.
- It requires less data which can be got easily since it covers a small sector.
- It is suitable because of the wide difference in the level of development between regions.
- Political instabilities in some regions make it a good idea to develop some areas first and others follow later.

Disadvantages of partial planning

- Partial planning leads to wastage of resources because of many un coordinated plans.
- The economic objectives of the plan may turn out to be divergent with the implementation. I.e. what is planned may not be what is implemented.
- Investments may not be regulated in an economy and this may lead to inflation.
- It leads to regional imbalances since some regions may develop at the expense of others.
- It may lead to underutilisation of resources since some areas are not planned and catered for.

b) Comprehensive plan

This is a plan which covers all sectors of the economy. It is a more advanced form of planning which is aggregate in nature and covers the entire country.

Merits of comprehensive planning

- It provides time long enough for survey into the resources to be made.
- It encourages interdependence since linkages between different sectors are possible.
- It allows looking far into the future which gives good ideas on priority sectors and planners will concentrate more on such sectors.
- It encourages full utilisation of the resources in an economy.
- It reduces regional inequality since all sectors are planned for at the same time.
- It allows economic development to move hand in hand with economic development since plans are for the development of the economy as a whole.
- It caters for the problems that may be going on in the economy at a particular period of time such as unemployment, poverty, and inflation among others.
- It helps to determine the sources of finance that may be needed for the development of the country for a period of time.

Demerits of comprehensive planning

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

12.3 Planning Under Different Economic Systems

Facts

12.3.1 Centralised planning

This is a form where the whole process is under the central planning authority (government) which formulates the central plan, sets objectives and goals without consulting the local people. It can also be known as top to bottom planning.

Merits of centralised planning

- The plans drawn are for high-level development of the nation. It collects all the skilled labour in the nation for its formulation and implementation.
- They are always consistent with national development objectives. They are consciously drawn and cannot divert from national set targets.
- They are flexible; they can be changed according to variations in national goals.
- Different stake holders participate in implementing of the plans and evaluation process especially the donors.
- The government is aware of the source of funds that may be needed in the implementation of the plans.
- The government knows what the general public needs and where it should put what, so long as it is in line with the development goals of the nation.

Demerits of centralised planning

- Poor quality work is likely to arise. This is mainly because there is a supply of poor managers and low skilled personnel in several regions of developing countries.
- When disaster befalls an area, centralised planning is hard, this is true because the people in the locality and the resources will all be affected or even destroyed.

- More information from other already developed areas is needed to make centralised planning successful. This may take some time or even be expensive.
- The local people always suggest what they think is important to them which some times may not be in line with the government objectives

12.3.2 Decentralised planning

This is type of planning which starts from the grass roots where the plan is formulated by the central authority after consulting different units such as ministries and local people. It can also be known as bottom to top planning.

Merits of decentralised planning

- It reduces the burden on the top administrators. The plans are drawn and implemented by the local people without giving much burden to the central administrators.
- There is quicker decision making in plan formulation. This is mainly because the local people know their challenges and possibly also the possible solutions.
- Decentralised plans improve upon the motivation and morale of the local people. A sense of belonging arises since they participate in the planning for and development of their society.
- Decentralised plans enhance communication between leaders and their masses. This is mainly because the leaders are within their reach.
- Decentralised plan implementation is easy to implement and monitor. This is because implementers and supervisors are in the same locality.

Demerits of decentralised planning

- Poor quality work is likely to arise. This is mainly because there is a supply of poor managers and low skilled personnel in several regions of developing countries.
- When disaster befalls an area, decentralised planning is hard, this is true because the people in the locality and the resources will all be affected or even destroyed.
- More information from other already developed areas is needed to make decentralised planning successful. This may take some time or even be expensive.

12.4 Current Development Plans in Rwanda

12.4.1 Pillars of Vision 2020

Activity 4

Analyse the figures below & undertake research from the library or the internet to answer the questions that follow.

Figure 3: Rwanda's future expectations.

Required:

(i) Identify what is being described in the photos A, B & C in the photos above.

(ii) As seen in photo B above, 'FUTURE VISION', which policy outlines the future vision of Rwanda?

(iii) Explain the objectives and pillars of the policy stated above?

(iv) Describe the challenges of the above policy.

Facts

12.4.2 Background

Vision 2020 was a result of a national consultative process that took place in Village Urugwiro between 1998-1999. There was a broad consensus on the necessity for Rwandans to clearly define the future of the country. This process provided the basis upon which this Vision was developed. Since then, Rwanda has made much progress towards attaining these objectives and even surpassed some of the targets. The original Vision 2020 targets through a consultative process were revised at the 9th Leadership retreat in February 2012. The original Vision 2020 contained 47 indicators and targets, which have been revised to a total of 48.

The guiding rationale for the revision was based on the following:

1. Aligning targets to level of low middle income countries an analytical comparison has been made of Rwanda and middle income countries and adjustments made where necessary.
2. Harmonising with the more ambitious seven -year government programme (7YGP) targets.
3. Inclusion of indicators and targets for climate change, governance, ICT and regional integration.
4. Some targets already achieved requiring more ambition out of the original 47 indicators in the Vision 2020.

12.4.3 Pillars of vision 2020

The aspirations of vision 2020 will be realised around six "Pillars" and will be interwoven with three cross-cutting issues. The Pillars include:

1. **Good Governance and a Capable State**

   Rwanda will become a modern, united and prosperous nation founded on the positive values of its culture. The nation will be open to the world, including its own Diaspora. Rwandans will be a people, sharing the same vision for the future and ready to contribute to social cohesion, equity and equality of opportunity.

   The country is committed to being a capable state, characterised by the rule of law that supports and protects all its citizens without discrimination. The state is dedicated to the rights, unity and well-being of its people and will ensure the consolidation of the nation and its security.
2. **Human Resource Development and a Knowledge-based economy**

   Apart from raising the general welfare of the population, improvements in education and health services can be used to build a productive and efficient workforce. This will be essential for Rwanda to become a sophisticated knowledge-based economy.

3. **Private Sector-led Development**

For Rwanda's development, the emergence of a viable private sector that can take over as the principle growth engine of the economy, is absolutely key. Not only will such a development be conducive for economic growth, but it will also ensure the emergence of a vibrant middle class of entrepreneurs, which will help develop and embed the principles of democracy.

4. **Infrastructure Development**

The rehabilitation and development of infrastructure is a crucial aspect in lowering the costs of doing business in Rwanda, which will attract domestic and foreign investment. As Rwanda is characterised by acute land shortage, a land use plan is needed to ensure its optimal utilisation in urban and rural development.

5. **Productive high value and market oriented agriculture**

Rwanda's economic policies since independence are said to have targeted agriculture as the main engine of economic growth. However, the agricultural sector has continued to perform poorly, with consistently declining productivity. It will be necessary to formulate and implement realistic developmental policies that move beyond past delusions of viable subsistence-based agriculture.

The key policy areas that need urgent attention to bring about this transformation include the following:

- Institutional and legal reforms to ensure security of land ownership.
- Development of a market in land assets.
- Extensive research and extension services.
- Investment in rural infrastructures.
- Use of high yielding varieties and intensive input use, especially fertilisers
- Promotion of agro-based manufacturing.
- Environmental control measures to halt the decline in soil fertility.
- Rural financing schemes and markets.

6. **Regional and International Integration**

Rwanda considers regional economic integration as one of the crucial elements of achieving Vision 2020. To this end, it will be necessary to pursue an open, liberal trade regime, minimising barriers to trade as well as implementing policies to encourage foreign direct investment. Economic zones for ICT based production will be crucial for enhancing competitiveness of Rwandan firms.

12.4.4 Crosscutting priorities

There are three cross-cutting areas of gender, natural resources and environment and culture, science and technology. These issues will not only be affected by the economic transformation but will also play an important role in achieving the VISION's development goals.

1. **Gender equality**

   Women make up 53% of the population and participate in subsistence agriculture more than men. They usually feed and provide care for the children and ensure their fundamental education. But until recently, girls were the minority in secondary schools, women had little access to the opportunities available to men and they were poorly represented in decision-making positions.

   In order to achieve gender equality and equity, Rwanda continuously updates and adapts its laws on gender. It supports education for all, eradicates all forms of discrimination, fights against poverty and practices a positive discrimination policy in favour of women. Gender is integrated as a cross-cutting issue in all development policies and strategies.

2. **Natural resources and the environment**

   The major problem in the field of environmental protection in Rwanda is the imbalance between the population and the natural resources (land, water, flora and fauna and non-renewable resources, which have been degrading for decades). This degradation is observed through massive deforestation, the depletion of bio-diversity, erosion and landslides, pollution of waterways and the degradation of fragile ecosystems, such as swamps and wetlands.

   The average population growth of 3% per annum during the 1980's to 1990's period was faster than that of agricultural production, estimated at 2.2%. This has led to the occupation of more and more marginal areas and to the rapid and continuous soil degradation of the fragile ecosystems of the country. In order to ensure sustainable development, Rwanda will implement adequate land and water management techniques, coupled with a sound biodiversity policy.

3. **Science, technology and ICT**

Rwandans are rightly proud of their cultural roots and the government will ensure that it takes advantage of this heritage in all facets of the development process. However, for this development process to be a success, Rwanda must embrace the future and exploit innovations in Science and technology to complement its cultural strengths.

By 2020, Rwanda projects to have adequate, highly skilled scientists and technicians to satisfy the needs of the national economy.
In order for Rwanda to achieve this objective, it has developed the teaching of science and technology at secondary and university levels. It facilitates the creation of high and intermediate technology enterprises and develop access to ICT down to the administrative sector level, in accordance with the national ICT plan.

12.4.5 Major objectives of vision 2020

Facts

The vision seeks to fundamentally transform Rwanda into a middle-income country by the year 2020. This will require achieving annual per capita income of US$ 900 (US$ 290 today), a poverty rate of 30% (64% today) and an average life expectancy of 55 years (49 years today).

Taking into account Rwanda's extremely scarce resources, prioritisation and sequencing will be crucial and will be tackled in short, medium and long run.

1. **Short Term**: Promotion of macroeconomic stability and wealth creation to reduce aid dependency.

- Rwanda will put into place macro-economic stabilisation policies that are conducive for private sector development. This, together with expanding the domestic resource base and increasing exports, is the only way to lessen aid dependence.
- The imbalances highlighted have been a source of macro-economic instability and have led to an unsustainable debt burden and dependency on foreign aid. To reduce this dependency, it will be crucial to develop effective strategies to expand the tax base, attract foreign investors and address the debt situation. Also, diversification and the development of non-traditional exports need to be promoted as well as addressing the anti-export bias in public policies.

- Envisaged policies, some of which are already being formulated and implemented include trade liberalisation, privatisation, tax reforms, competitive exchange rates and market driven interest rates. Government will desist from providing services that the private sector can deliver more efficiently and competitively. With these policies in place, the economy will be able to take up the challenge of transforming from an agrarian subsistence economy into a sophisticated knowledge-based society.

2. **Medium Term**: Transforming from an agrarian to a knowledge-based economy.

- As for services, in the medium to long term, this sector will become the most important engine of Rwanda's economy. Since Rwanda is landlocked and has limited natural resources, the government should take a lead role in designing policies geared towards encouraging investment in services, to acquire and maintain a competitive edge in the region.
- Even if Rwanda's agriculture is transformed into a high value/high productivity sector, it will not, on its own, become a satisfactory engine of growth. There has to be an exit strategy from reliance on agriculture into secondary and tertiary sectors. The issue, however, is not simply one of a strategy based on agriculture, industry or services, but rather, identifying Rwanda's comparative advantage and concentrating strategies towards it. For instance, there is a plentiful supply of cheap labour, a large multi-lingual population, a strategic location as the gateway between East and Central Africa as well as its small size, making it easy to build infrastructure (resources permitting).
- The industries established would need to address basic needs, for which there is a readily available market, as these products can satisfy local demand and even move towards export. It should be noted that the elaboration of such policies will not be sufficient to achieve a knowledge based economy. Major infrastructural investment will be required in the areas of energy, water, telecommunication and transport to reduce costs, whilst increasing their quality and reliability. Improvements in education and health standards will be crucial for providing an efficient and productive workforce.

Figure 4: Transformation of economic activity 2000-2020

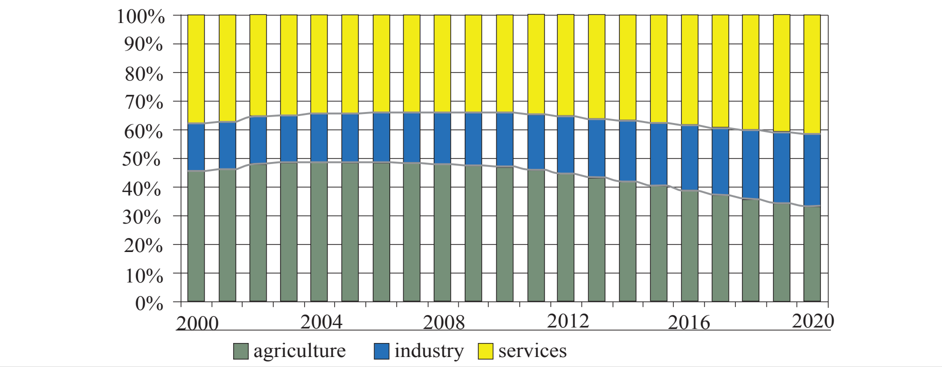


Figure 4 above shows that by 2020, there will be a reduction on dependence on agriculture while the economy will instead increase productivity in industry and services.

3. **Long Term**: Creating a productive middle class and fostering entrepreneurship.

- The developmental process and capital formation cannot in the long run be achieved by the state or by donor funds alone. While both of these must contribute, the backbone of the process should be a middle class of Rwandan entrepreneurs. Productive entrepreneurship must be fostered to perform its traditional role of creating wealth, employment and vital innovations through opportunities for profit.
- Stimulating the private sector, particularly with regard to the promotion of exports and competitiveness is not achievable without broadening and deepening the financial sector such as banking, insurance and the application of information technology. Provision of high quality educational services in sciences and technology will be necessary for consolidating development gains made in the short and medium term. Rwanda should also aim to find a niche market in the region, for example, becoming a telecommunications hub.

It is envisaged that with these reforms, Rwanda will transform from a subsistence agricultural economy to a knowledge-based society, with a vibrant class of entrepreneurs.

12.4.6 Major challenges of vision 2020

- Diminishing agricultural productivity and arable land distribution: Agriculture accounts for more than 90% of the labour force, yet remains unproductive and largely on a subsistence level. Distribution of arable land now stands at one hectare for every 9 Rwandans and is diminishing due to high birth rates. The obvious consequence is that a substantial number of rural families who subsist on agriculture own less than 1 hectare, which is too small to earn a living.
- Natural barriers to trade: Rwanda is land-locked, with long distances from ocean ports; a factor that raises transportation costs for both exports and imports. The country lacks a link to regional railway networks, which means most trade is conducted by road. Poor road quality creates high transportation costs leading to inflated prices of domestically manufactured products, as raw materials used for manufacturing need to be imported.
- Narrow economic base: It is clear that increases in the productivity and exports of coffee and tea alone, will not be sufficient to build the Rwandan economy. Therefore, efforts need to be made to expand the economic base and especially exports. Although there are small pockets of various high value minerals in Rwanda, there is no single natural resource of sufficient quantity that will kick-start the economy.
- Weak institutional capacity: Governance, including the management of public resources remains insufficient due to lack of sound institutions and competent personnel. Rather than develop sound systems themselves, past governments continued to rely on foreign technical assistance that was both costly, largely indifferent to domestic long term needs and failed to build local capacities. Although great progress has been made on this front, it still represents a significant hindrance to effective governance.
- Low level of human resource development: The severe shortage of professional personnel constitutes an obstacle to the development of all sectors. Lack of adequately trained people in agriculture and animal husbandry hampers modernisation of this sector, whilst a shortage of technicians and competent managers severely constrain the expansion of the secondary and tertiary sectors.

- Public debt: Rwanda's public debt constitutes a major obstacle to its economic development. Public debt has been accumulating at a rate higher than the country's capacity to generate wealth to service the debt. A return to sustainable level of debt, where existing debt can be serviced comfortably without jeopardising the country's growth prospects, had been reached by 2015.
- Social and economic consequences of the genocide: The 1994 Genocide devastated the Rwandan economy as well as its population. GDP was halved in a single year, eighty percent of the population was plunged into poverty and vast tracts of land and livestock were destroyed. The genocide also exacerbated a number of development constraints, which existed before 1994. The already poorly developed productive infrastructure was completely destroyed and the nation was robbed of a generation of trained teachers, doctors, public servants and private entrepreneurs.

  Thus, the consequences of genocide have devastated Rwanda's social, political and economic fabric. Without successful reconciliation, political stability and security, private investors will not develop confidence in the country.

12.5 Economic Development and Poverty Reduction Strategies 1 (EDPRS 1: 2008-2012)

12.5.1 Background of EDPRS 1

Activity 5

Use the library or internet to research and answer the following questions:

(i) What are the strategies that have been used by EDPRS1to achieve its objectives?

(ii) Discuss the achievements of EDPRS 1.

Facts

In 2007, the government of Rwanda launched the EDPRS as the second generation of the poverty reduction strategy for the period 2008-2012 to ensure that social and economic life is more streamlined and harmonised. It replaced the poverty reduction strategy paper (PRSP) which had been in operation between 2002 to 2005 with an aim of reducing poverty. The EDPRS provides a medium term framework for achieving the country's long term development aspirations as embodied in Rwanda's vision 2020. Both vision 2020 and EDPRS are consistent with the Millennium Development Goals (MDGs).

The EDPRS 2008-2012 sets the country's development objectives, priorities and policies for the period through three flagship programmes that aim at reducing inequality and poverty.

Under EDPRS 1, priority was therefore, given to accelerating growth, creating employment and generating exports. These were outlined in three flagship programmes named below:

(a) Growth for jobs and export
(b) Governance
(c) Vision 2020 *umurenge*

12.5.2 Objectives of EDPRS 1

Lessons from the evaluation of the Poverty Reduction Strategy Paper (PRSP-2002-2005) suggested that the principal problems in the public sector relate to the implementation of the policy, for example, the fertiliser needs were identified as a priority and even though resources existed, targets were not met. Employment creation was also acknowledged as a priority but was not sufficiently pursued. Sectors knew what to do but they were less clear as to how to do it and tended to work in isolation from each other.

This review of Rwanda's recent socio-economic performance together with the lessons from the PRSP suggested four priorities/objectives for the EDPRS:

1. Increase economic growth by investing in infrastructure: promoting skills development and the Service Sector; main-streaming Private Sector development and modernising agriculture by introducing

improved land administration, land use management practices and adopting techniques to reduce soil erosion and enhance soil fertility.

2. Slow down population growth through reducing infant mortality: family planning and education outreach programs, while also improving the quality of health care and schooling, particularly for girls.
3. Tackle extreme poverty through improved food security and targeted schemes of job creation and social protection: It was particularly urgent to create new employment opportunities for young persons just entering the labour market.
4. Ensure greater efficiency in poverty reduction through better policy implementation which included enhanced coordination among sectors and between levels of government; sharper prioritisation of activities; better targeting of services for the poor; widespread mobilisation of the Private Sector; and the more effective use of monitoring and evaluation mechanisms.

12.5.3 Strategies to achieve the above objectives or priorities

1. Sustainable growth for jobs and exports, was to be driven by an ambitious, high quality public investment programme aimed at systematically reducing operational costs of business, increasing capacity to innovate, widening and strengthening the financial sector. This meant heavy investment in hard infrastructure by the government to create strong incentives for the private sector to increase its investment in the subsequent years.
2. The sectoral allocation of public expenditure was to be distributed to maintain momentum in social sectors like education, health, water and sanitation while also targeting agriculture, transport and information and communication technology, energy, housing and urban development, good governance and rule of law, proper land use management and environmental protection.
3. In agriculture, the main programmes included the intensification of sustainable production systems in crop cultivation and animal husbandry, building the technical and organisational capacity of farmers, promoting commodity chains and agribusiness, and

strengthening the institutional framework of the sector at central and local level.

4. Environmental and land policies involved ecosystems, the rehabilitation of degraded areas and strengthening newly established central and decentralised institutions. Special attention was to be paid to sustainable land tenure security through the planning and management of land registration and rational land use, soil and water conservation, reforestation, preservation of biological diversity and adaptation and mitigation against impact climate change.
5. In education and skills development, the emphasis was on increasing the coverage and the quality of the nine-year basic education, strengthening technical and vocational education and training (TVET) and improving the quality of tertiary education.
6. The concerted effort to build scientific capacity was to be based on the objectives of knowledge acquisition and deepening, knowledge creation through scientific research and knowledge transfer.
7. In infrastructure, the objective was to reduce transport costs within the country and when connecting to the outside world and to ensure security of energy supplies by increasing domestic energy production from several sources. Efforts were made to promote investment in, and the growth of, the Information and Communications Technology industry. In meteorology, the aim was to provide a wide range of timely, high quality information to different groups of users.
8. In addition to reducing the costs of doing business, the government was to promote competitiveness and Private Sector development through capacity building initiatives, credit schemes and Business Development Services (BDS). In manufacturing, the government was to promote value addition in existing product lines in agro-processing, including coffee and tea, handicrafts and mining, and development of new products including silk, pyrethrum, hides and skins and flowers. The government would also provide incentives for foreign direct investment and create industrial parks and export processing.
9. The Service Sector is fundamental for the transition towards a knowledge-based society. The high population growth was a major challenge facing Rwanda. Slowing down population growth required innovative measures, including the strengthening of reproductive

health services and family planning and ensuring free access to information, education and contraceptive services.

10. The Water and Sanitation Sector aimed at ensuring sustainable and integrated water resources management and development for multipurpose use including increased access to safe water and sanitation services for all.

12.5.4 **Achievements of EPDR1**

The achievements under EDPRS 1 have been described as the perfect development "hat trick" of growth, poverty reduction and reduction in inequality which have put Rwanda back on track to achieve the Millennium Development Goals (MDGs). Economic growth averaged 8.2% over the period while poverty reduced from 56.7% to 44.9% allowing more than 1,000,000 Rwandans to be lifted out of poverty in less than five years. Income inequality also reduced to 0.49 in 2011 below the level of 2001.

Ownership of the EDPRS by a wide range of stakeholders at national level has been a key factor of success. The EDPRS 2 has integrated inclusiveness and sustainability as driving factors in elaborating the strategy. Among the achievements are the following:

- Home-grown initiatives turned into success stories in strengthening the delivery of EDPRS 1. These include: *Umuganda* (community work), *Gacaca* (truth and reconciliation traditional courts), *Abunzi* (mediators), *Imihigo* (performance contracts), etc. Scale-up of home grown solutions forms an integral part of the EDPRS 2 with particular focus on identifying innovations.
- Community-based solutions: working closely with the population, have made possible fast-track and cost effective implementation and increased demand for accountability, in education with the nine-year basic education construction of classrooms, the Crop Intensification Programme (CIP) in agriculture, and community based health care programmes. This approach supporting community empowerment and involvement will be scaled up and supported in the EDPRS 2.

- Use of ICT solutions improved service delivery: Some of the biggest successes in service delivery and investment climate reforms have been centreed on ICT solutions such as online registration of businesses, online filing of tax claims to mention but a few. The EDPRS 2 targets are taking Rwanda to the brink of middle income status requiring even greater performance in service delivery from both public and private sectors. ICT is considered an important aspect in developing the knowledge based economy.
- An adequate institutional and legal framework for implementation, but with flexibility to change or adapt has proven effective (e.g. RDB, REB, EWSA, etc.). In many instances, merging institutions with closely complementary mandates have reduced duplication and improved coordination. Innovation within the institutional framework has been fully considered and teased out in the EDPRS 2, key areas identified for reform geared towards increased efficiency of delivery include: The National Employment Programme, the Urbanisation and Rural Settlements Institutional Framework and the Investment process.

Table 1: Targets and achievements of EDPRS1

Priority area	Indicator		Baseline	Target 2012	Actual
		2006		2011/12	
Growth and poverty reduction	1.	Real GDP growth (% annual)	6.5	8.1	8.2 (2008-12)
	2.	Export growth (% annual)	10	15	25.1 (2008-12)
	3.	National investment (% of GDP)	16.3	24.4	22.5
	4.	Share of population living in poverty (%)	57	46	44.9
	5.	Share of population living in extreme poverty (%)	37	24	24.1

	6.	Poverty incidence among people living in female-headed households (%)	60	48	47.0
	7.	Employment in agriculture (% reporting as main occupation)	80	70	71.6
	8.	Number of new jobs created		140,000	177,362
Widen and strengthen the financial sector	9.	Private Sector credit (% of GDP)	10	13.9	14.5
	10.	Financial depth (broad money/GDP)	20	22.5	21.3
Develop skills	11.	Pupil/teacher ratio in primary schools	73:1	60:1	62:1
	12.	Gross secondary school enrolment	10	30	38.0
Raise agricultural productivity and ensure food Security	13.	% of agricultural land protected against soil erosion	40	90	92.0
	14.	Area under irrigation (hectares)	15,000	24,000	24,131
	15.	Use of mineral fertiliser (MT)	14,000	47,600	46,000
	16.	Livestock in intensive systems (%)	16	55	60
Land and environment	17.	Forestry coverage (%)	20	22.7	24.5
	18.	Land titles issued	8,000	7 million	4.2 million
	19.	Area of land protected to maintain biological diversity (%)	8	9.6	10.1

Priority area	Indicator		Baseline	Target 2012	Actual
		2006		2011/12	
Build infrastructure	20.	Households with access to electricity (number of households)	70,000	270,000	308,326
	21.	Electricity generation (off/ on grid, MW)	45	120	110
	22.	Classified national road network in good condition (%)	11	63	68
	23.	ICT penetration rate (%)	26	40	44
Improve health status and reduce population growth	24.	Infant mortality (deaths per 1,000 live births)	86	70	50
	25.	Maternal mortality (deaths per 100,000 live births)	750	600	476
	26.	Population covered by health insurance schemes (%)	70	90	89
	27.	Women aged 15-45 using modern contraceptive techniques (%)	10	44	47.7
	28.	Incidence of HIV among 15-24 year olds (%)	1	0.5	NA
	29.	Total Fertility Rate (children per woman)	6.1	4.5	4.6

Increase access to safe drinking water and sanitation strengthen governance, security and the rule of law	30.	Access to safe drinking water (% of population)	64	83	74
	31.	Access to hygienic sanitation	38	63	74.5
	32.	Share of population expressing satisfaction/ confidence in decentralised governance (%)	85	100	68

Table 1 above shows the targets and achievements of EDPRS1

12.5.5 Challenges faced by EDPRS 1 addressed in EDPRS 2

Activity 6

Use the library or internet to research about the challenges faced by EDPRS1and thereafter share your views in your class discussion.

Facts

- Some sectors at the end of EDPRS 1 still lacked exhaustive and well-articulated strategies: the EDPRS 2 has been developed based on a comprehensive elaboration process that included stakeholders from the district level to the national level. The EDPRS 2 is developed taking into consideration: 30 District Development Strategies, City Development Plan for Kigali City, 16 Sector Strategies at National level and 4 Thematic Area Strategies.

- Insufficient coordination and communication across sectors as well as between central and local government entities. In general, districts and sectors both expressed need for better sharing of information and improved coordination for implementation among others. The EDPRS 2 introduced four Thematic Areas: i.e. Economic Transformation, Rural Development, Accountable Governance and Productivity and Youth Employment. These thematic areas seek to level planning and ensure that planning is driven by commonly understood goals and objectives. The focus on joint planning and cross-sectoral action was further emphasised.
- Insufficient involvement of the private sector in some areas affected the quality of policy dialogue and engagement of private sector in implementation. The EDPRS 2 requires that every sector identify private sector players and engage them in developing their respective strategies. This was achieved and taken forward as a principle for the EDPRS 2 including the refinement of Public Private Dialogue and the adoption of private sector investment targets for line ministries.
- Mainstreaming cross-cutting issues needed strengthening: While sectors and districts acknowledged progress in integrating cross-cutting issues, they also highlighted the need for more tools and guidance on effectively mainstreaming crosscutting issues into their plans, budgets and Monitoring and Evaluation (M&E). The EDPRS 2 considers guidelines from lead institutions on all seven crosscutting issues for integration into thematic, sector and district strategies. The development and collection of specific disaggregated indicators will be further developed moving forward.
- Weak Monitoring and Evaluation (M&E) systems: Districts and sectors pointed out the need for an integrated M&E system that links the different sub-systems. By developing a strong linkage between M&E outcomes from the thematic, to sector and district levels, the EDPRS 2 provides a platform for increased effectiveness of the M&E system. The planned introduction of an integrated electronic M&E system for district and national levels will further facilitate the M&E process during EDPRS 2.

12.6 Economic Development and Poverty Reduction Strategy II (EDPRS 2: 2013-2018)

Activity 7

Use the library or internet to research and attempt the following:

(i) Why was EDPRS 2 introduced by the Government of Rwanda?

(ii) What are the thematic areas on which EDPRS 2 is based?

(iii) Explain the principles that are addressed in EDPRS 2.

Figure 1: Achievements of EDPRS strategies

Figure 1: A biker from southern province testifies about his achievements in EDPRS 2 strategies

12.6.1 Background of EDPRS 2

Based on the experience of Poverty Reduction Strategy Paper (PRSP), it was evident that the social sectors (particularly health and education) had made significant progress, while the productive sectors including agriculture, infrastructure and industry remained a challenge. Under EDPRS 1, priority was therefore given to accelerating growth, creating employment and generating exports. These were outlined in three flagship programmes: Growth for Jobs and Exports, the Vision 2020 *Umurenge* (VUP), and Good Governance.

Phase two of Poverty Reduction Strategy (EDPRS 2) makes a distinction between emerging priorities reflected in thematic areas and ongoing priorities under foundational issues. The combination of these priorities provides the framework for the EDPRS 2 strategy.

There are four thematic areas each designed to address specific objectives in line with the overall goal of EDPRS 2, these include:

1. Economic transformation for accelerated economic restructuring and growth striving for middle income country status.
2. Rural development to address the needs of the vast majority of the population and ensure sustainable poverty reduction and rural livelihoods.
3. Productivity and Youth Employment to ensure that growth and rural development are underpinned by appropriate skills and productive employment, especially for the growing cohort of youth.
4. Accountable Governance, to underpin improved service delivery and citizen participation in the development process.

EDPRS 2 and its four thematic areas have been built from five principles derived from the lessons and experience of EDPRS 1 and the overarching ambitions set for EDPRS 2. These principles are:

1. Innovation: Emphasising new ways of thinking, working and delivering because the status quo will not be adequate to achieve Rwanda's ambitious targets.
2. Emerging priorities: Identifying thematic strategies which encompass new priorities, including new ways of doing business, to drive the achievement of Vision 2020 targets.
3. Inclusiveness and engagement: Creating ownership of development at all levels and providing learning and feedback mechanisms to improve solutions.

4. District-led development: Creating strong, mutually supporting linkages between district and sectoral strategies, and supporting administrative standardisation and efficiency.
5. Sustainability: Ensuring that programmes and targets achieved from EDPRS 2 are sustained over the long term in their economic, social and environmental dimensions.

12.6.2 Objectives of EDPRS 2

The major goal is;

"Accelerating progress to middle income status and better quality of life for all Rwandans through sustained average GDP growth of 11.5% and accelerated reduction of poverty to less than 30% of the population"

Rapid Economic	+	Reduce Poverty to
Growth (Avg. GDP		
		under 30%
growth of 11.5%)		

Objectives of EDPRS 2

- To ensure economic growth to middle income status
- To continue poverty reduction
- To provide more off farm jobs and continued urbanisation
- To reduce external dependency
- To ensure the private sector as the engine to growth.

Table 2: Objectives and targets by 2020

Objectives	Vision 2020 targets
Rapid economic	* GDP per capita of
growth to Middle	$1240
Income status	* Avg. GDP growth of 11.5%

Increased	* Poverty reduced to
Poverty	20%
Reduction	* Extreme poverty
	Eliminated
More off-farm	* 1.8 million new off-
jobs, more	farm jobs
Urbanisation	* 35% of population
	Urban
Reduced external	* Exports growth of 28%
Dependency	p.a.
Private sector as	* Private sector takes
engine of growth	dominant share of
	Investment

Table 2 above shows the objectives and targets by 2020

12.6.3 Thematic areas to be addressed in EDPRS 2

The four thematic areas are further explained below with the strategies of how they are to be achieved;

1. Economic transformation

This thematic area targets accelerated economic growth (11.5% average) and restructuring of the economy towards more services and industry as we move towards middle income country status. The main targets relate to; strategic infrastructure investment for exports, increased private sector financing for increased exports coverage of imports, urbanisation and green economy approach for sustainability.

Five priority areas identified to spearhead this thematic strategy:
Priority 1: Increasing the domestic interconnectivity of the Rwandan economy through investments in hard and soft infrastructure by meeting the energy demand of the private sector; increasing access to public goods and resources in priority sectors of the economy; and deepening the integration of key value chains.

Priority 2: Increasing the external connectivity of Rwanda's economy and boosting exports by building a new international airport, expanding RwandaAir, and finalising planning for an appropriate railway connection along the Central Transport Corridor to Dar- es-Salaam or to Uganda; transforming Rwanda's logistics system and strengthening export promotion.

Priority 3: Transforming the private sector by increasing investment in priority sectors. The investment process will target large foreign investors in priority sectors of the economy; accelerate measures to increase long-term savings, transform the financial sector for increased access to long term international and domestic financing for private sector, strengthen tax and regulatory reform to spur medium and large enterprise growth and attract large investors.

Priority 4: Transforming the economic geography of Rwanda by facilitating urbanisation and promoting secondary cities. Six secondary cities will be developed as poles of growth and centres of non-agricultural economic activities. This will require investment in specific hard and soft infrastructure and strategic economic projects that will trigger growth of these cities and enhance linkages to other towns and rural areas. Affordable housing will also be a key element of increased attractiveness of these cities. Kigali will continue to be developed as a regional hub.

Priority 5: Pursuing a 'green economy' approach to economic transformation. The green economy approach favours the development of sustainable cities and villages. Key innovations include: piloting a green city, piloting a model mine and attracting investors in green construction interventions who will focus on green urbanisation and the promotion of green innovation in industrial and private sectors.

2. Rural development

This thematic area is focused on ensuring that poverty is reduced from 44.9% to below 30% by 2018. This will be achieved through focus on increased productivity of agriculture which engages the vast majority of the population and ensures sustainable poverty reduction.

Enhanced linkages of social protection programmes will also be developed with particular attention to increasing graduation.

Four priority areas identified to spearhead this thematic strategy:
Priority 1: Integrated approach to land use and human settlements. Two functions are strengthened in this priority. The overall land use allocation for development and the decentralised process of land allocation and management. A major consideration is ensuring that rural settlements are revisited to ensure greater access to economic opportunities and basic services.

Priority 2: Increasing the productivity of agriculture by building on the sector's comparative advantage. The focus is therefore on irrigation and land husbandry, proximity advisory services for crops and livestock and connecting farmers to agribusiness.

Priority 3: Enabling graduation from extreme poverty by monitoring graduation through a database across social protection programmes, supporting financial products, services and literacy for the poorest, strengthening *Umurenge* SACCOs, and improving the coverage and targeting of core social protection programmes such as VUP. Graduation will also mean linking the poorest to economic activity through the provision of skills.

Priority 4: Connecting rural communities to economic opportunity through improved infrastructure.

3. Productivity and youth employment

This thematic area is focused on ensuring that growth and rural development are underpinned by appropriate skills and productive employment, especially for the growing cohort of youth. The main objective is the creation of at least 200,000 new jobs annually.

Four priority areas identified to spearhead this thematic strategy:
Priority 1: Developing skills and attitudes by reviewing and reforming national education curricula, establishing Sector Skills Councils, strengthening TVET, promoting adult literacy and short course basic skills training, a tripartite funding system for on-the-job training, and a youth entrepreneurship mentoring programme.

Priority 2: Promoting technology with a focus on accelerating innovation by internet and mobile phone infrastructure and improving ICT skills.

Priority 3: Stimulating entrepreneurship, access to finance and business development by increasing off-farm employment, productivity and new job creation driven by the private sector. The government is consolidating, rationalising and expanding different business support programmes into an Integrated national employment programme to boost entrepreneurship and job creation.

Priority 4: Labour market Interventions. Government is improving the efficiency of labour markets by assisting job seekers to match with job providers through Employment service and career advisory centres.

4. Accountable governance

The objective of this thematic area is to improve the overall level of service delivery and ensure citizen satisfaction above 80%. It also focuses on increased citizen participation as a way of ensuring ownership and feedback for efficiency and sustainability.

Four priority areas identified to spearhead this thematic strategy:
Priority 1: Strengthening citizen participation and demand for accountability by using "home grown initiatives" to promote citizen participation; using ICT and radio to promote participation and development of communication; strengthening the media and civil society organisations to better fulfil their developmental role and strengthening administrative decentralisation.

Priority 2: Improving service delivery. To revitalise service delivery in the public sector as well as in the private domain, the government is embarking on development of a customer-centred service delivery culture, the design of policies and the establishment of standards of customer services.

The four thematic areas together with their strategies are the principles that can help to solve the problems faced by EDPRS 1 and at the same time help to achieve the objectives of EDPRS 2.

Unit assessment

1. a)............................is the type of plan prepared and implemented by the central government after consulting various organs. While .... is a plan prepared by the government and it provides information to the private sector without influencing their decisions directly. b) Explain the importance of economic planning towards a country's development.
2. Explain the reasons as to why many economic development plans in developing countries have not achieved their major objectives.
3. What has been achieved in the vision 2020 policy in Rwanda?

Glossary

- **Annual plan**: A plan which cover a short term period of time usually a year.
- **Bottom to top planning**: A type of planning which starts from the grass roots where the plan is formulated by the local authority after consulting different units such as ministries and local people and then sent to the central authority for approval and financing.
- **Capitalist plan**: A plan common in market economies which emphasises the private sector as a way to bring development.
- **Comprehensive plan**: This is one which covers all sectors of the economy.
- **Comprehensiveness**: A good plan should cover the whole economy because of the linkages among the sectors.
- **Consistence**: A plan which has same characteristics without contradictions in the economy.
- **Compatibility**: A plan that is able to use the available raw materials.
- **Development planning**: This refers to a deliberate government attempt to influence and direct economic resources and activities towards specific objectives in a specified period of time.
- **Economic development planning**: This focuses on government attempt to influence and direct resources with an aim of achieving economic objectives.
- **Feasibility**: A plan which is politically and administratively feasible and can be easily implemented.
- **Indicative plan**: This is a plan prepared by the government and it provides information to the private sector without influencing their decisions directly.

- **Integrated public investment plan**: This is where the government estimates the national resources and allocates them among sectors and projects according to order of priority.
- **Imperative plan**: A plan prepared and implemented by the central authority in consultation with various organs, offices and agencies.
- **Medium term plan**: A plan which covers between 3-10 years.
- **Macro level planning**: This is planning for the economy as a whole.
- **Micro level planning**: Is planning for a few sectors in the economy.
- **National economic plan**: This is a plan for the whole nation which has to be consistent with the national resources.
- **Optimality**: This is putting to value the resources available to the most efficient way.
- **Proportionality**: A good plan must correspond to a bigger size of a region than concentrating on a small area.
- **Perspective**: This is a plan which covers more than 25 years and has got long term objectives intended to bring about development in the economy.
- **Project plan**: This is a plan undertaken by agencies like parastatals, farmers where by output is produced taking into account the resources available.
- **Partial plan**: This is a plan prepared on sectoral level such that it may cover one sector or part of the economy. It may also be called fragmentary or micro plan.
- **Project by project plan**: This is a plan which covers only the public sector and identifies projects which may not be directly related to the national development plan.
- **Relevance**: A good plan should be in line to achieve the intended goals and objectives because this makes it socially important.

- **Regional plan**: This is a plan which integrates all activities, programmes and projects within the region aimed at attaining national objectives.
- **Socialist plan**: This is a plan not based on market mechanism but by the government which owns and allocates resources by administrative directives.
- **Sequencing**: This principle involves putting in place minor projects to facilitate the major ones.
- **Sectoral plan**: This is a plan for individual sectors like agriculture, industry and such a plan can be made as part of the national plan by the relevant ministries.
- **Top to bottom planning**: This is a form where the whole process is under the central planning authority which formulates the central plan, sets objectives and goals without consulting the local people, plans are then forwarded to local authorities for implementation.

Unit summary

- Economic planning
  - Meaning
  - Rationale for planning
  - Principles of economic development planning
  - Obstacle to planning
- Classification of plans
  - According to time element
  - According to implementation
  - According to social- economic system
  - According to hierarchy of planning
  - According to coverage
- Vision 2020
  - Back ground
  - Pillars and cross-cutting priorities
  - Objectives and challenges
- Economic development and poverty reduction strategies
  - Back ground
  - Objectives and strategies
  - Achievements and challenges

Topic Area 5: Development Economics

Sub-Topic Area 5.4: Structure of Rwanda's Economy

UNIT 13

Sectors of the Rwandan Economy

Key unit competence: Learners will be able to describe the role of various sectors of Rwandan economy.

My goals

By the end of this unit, I will be able to:

- Describe the structure of Rwanda's economy and examine its implications to the development of the country.
- Explain the meaning, forms, advantages and disadvantages of dependence.
- Examine the forms, advantages and disadvantages of dualism.
- Analyse the meanings, limitations and role of the subsistence and informal sectors to the development of Rwanda.
- Compare the objectives, roles and problems facing the private and public sectors.
- Suggest policies to boost the private sector.
- Describe the forms, rationale and limitations of privatisation and liberalisation.

Activity 1

Case study 1

Rwanda, a beautiful land locked nation is located in the Central / Eastern Africa surrounded by Uganda, Kenya, Tanzania, Burundi and DR Congo. It is highly elevated with its geography dominated by mountains in the west and savanna to the east, with numerous lakes throughout the country. Rwanda has a population of over 12.6 million living on 26,338 km2 (10,169 mi2) of land and is the most densely populated mainland African country. Rwanda is one of only three countries in the world with a female majority in the national parliament, the two other countries being Bolivia and Cuba. Rwanda's developing economy suffered heavily in the wake of the 1994 genocide, but has since strengthened. The economy is based mostly on subsistence agriculture with coffee and tea as her major cash crops for export. Tourism is a fast-growing sector and is now the country's leading foreign exchange earner with mountain gorillas which when being visited, are paid for highly for gorilla tracking permits. To widen her market potentials, Rwanda joined the East African Community in 2007. Despite the progress made, Rwanda remains a very poor country, where just under 40% of the population lives below the national poverty line. In 2019, according to the National Institute of Statistics of Rwanda, 15.4% of the population was unemployed.

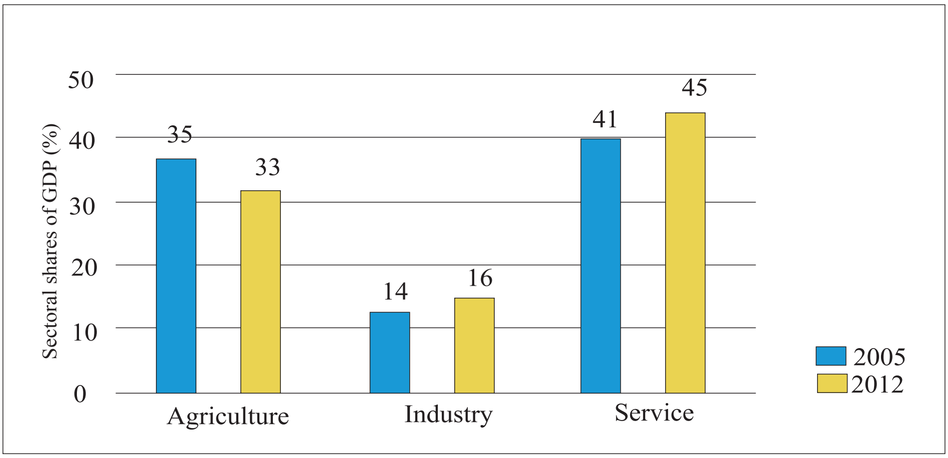
Basing on the case study above, discuss the following questions:

(i) Identify the basic features of the Rwandan economy mentioned in the case study?

(ii) Other than those features cited in the case study above, what are other salient features of Rwandan economy?

(iii) Examine the implications of the above features to the development of the economy of Rwanda.

Figure 1: Evolving structure of Rwanda's economy (2005-2012)



Source: National Institute of Statistics of Rwanda 2012 GDP Annual Estimates (2013)

The above figure 1 shows percentage contribution by 2012 according National institute of statistics of Rwanda. By October 2016, according to CIA world fact book, the statistics had shot up as shown below

Agriculture: 32.6%

Industry: 14.1%

Services: 53.3% (2015 est.)

13.1 Structure of Rwanda's Economy

Facts

Rwanda officially called the Republic of Rwanda occupies a total area of 26,338 square kilometers of which 24,668 square kilometers (94%) is land and 1670 square kilometers (6%) is open to water and swamps. It has a population of approximately 12 million (2015 statistics). The population is relatively younger and predominantly rural with density amongst the highest in Africa.

Structure of an economy is a range of characteristics or features that describe the economy of a country. These features range all the way from agriculture sector, industry, trade to the community sector. These sectors have each contributed the gross domestic product and greatly contributed towards the development of the country. The general structure of the economy can be seen below.

13.1.1 Structure of Rwanda's economy

Features of the economy

The Rwandan economy, the land of a thousand hills as it is known, is characterised by the following features:

Features of the economy.

- Rwanda is a country of few natural resources.
- The economy is based mostly on subsistence agriculture by local farmers using simple tools. An estimated 90% of the working population farms, and agriculture constituted an estimated 32.5% of GDP in 2014
- Despite Rwanda's fertile ecosystem, food production often does not keep pace with population growth, and food imports are required,
- Rwanda relies on agricultural exports which makes Rwanda vulnerable to shifts in export prices. i.e. Coffee and tea are the major cash crops for export.
- Production systems are mostly traditional, although there are a few intensive dairy farms around Kigali.
- Farming techniques are basic, with small plots of land and steep slopes.
- Shortages of land and water, insufficient and poor-quality feed and regular disease epidemics with insufficient veterinary services.
- Fishing takes place on the country's lakes, but stocks are much depleted, and live fish are being imported in an attempt to revive the industry.
- Rwanda has made tremendous strides in improving electrification in the 21st century. A great number of new areas has become electrified through an expansion of infrastructure.
- The industrial sector is small but growing, contributing 16.2% of GDP and 9% of employment with almost 70% of industries in Rwanda being located in Kigali, with little activity in the urban centers of the hinterland. The sector is strongly linked to the processing of primary agricultural products.
- Rwanda's manufacturing sector is dominated by the production of import substitutes for internal consumption. The larger enterprises produce beer, soft drinks, cigarettes, hoes, wheelbarrows, soap, mattresses, plastic pipe, roofing materials, and bottled water.

- Rwanda is a dual economy with the existence of two contrasting sectors one being advanced while the other backward. E.g. rich and poor, subsistence and commercial agriculture, educated and the uneducated etc.
- The tertiary sector contributes around 47.8% of GDP and employs 25% of the total workforce with tourism being one of the fastest-growing economic resources and became the country's leading foreign exchange earner in 2011.
- Rwanda is a mixed economy with both the private sector and the government participating in production.
- Rwanda is an open economy with great involvement in international trade with other countries around or far away.
- High population growth rate which is shown by the increasing number of children born.
- Rwanda is a dependent economy as it greatly depends on agriculture sector and foreign aid for her economic resources.
- In spite of the genocide's legacy, the country is increasingly perceived internationally as a safe destination due to her strong security.
- The government has increased investment in the transport infrastructure of Rwanda since the 1994 genocide, for example, the internal and external road network and airports linking places inside and outside the country, nearby and far places.

Implications of such a structure

The characteristics that describe the Rwandan economy have had implications that are both positive, i.e. they have helped in the growth of the economy, and negative i.e. they have slowed down growth. Some of these are shown below:

- Low export earnings because of the economy basing on agriculture as the major export and this is responsible for the balance of payment problem.
- Increased trade with other countries since the country is open and this provides market for the local goods hence leading to increase in foreign exchange earnings.

- Large subsistence sector implies low incomes to the people since most of what is grown is for home consumption and this has led to low incomes, savings, low capital accumulation and finally continuous poverty.
- Fast growing population implies limited social services and too much pressure on resources hence sometimes some are left stranded without the basic treatments and social services.
- Dependent economy implies that the country cannot be self-sustaining and high rates of capital outflow when paying back the loans acquired. This causes continuous balance of payment problem.
- Small but growing industrial sector implies low quality and quantity goods leading to low earnings from the manufacturing sector.
- Wide spread unemployment and underemployment imply high levels of depreciation of the educated human resource and also poverty and low standards of living.
- High levels of illiteracy implies low skills possessed by the people hence low levels of innovation and invention leading to importation of experts who are expensive leading to capital outflow.
- Being a dual economy implies that some areas develop faster than others and this leads to imbalance in development and income inequality among the sectors and regions.
- Mixed economy implies that there is both government and private sector in the economic activities and this reduces chances of monopoly and consumer exploitation.

These features of the economy can be explained in detail later.

13.2 Dualism (Dual Economy)

Activity 2

With reference to the case study in activity 1 above,

i) Identify situations that describe unequal developments between people, areas, sectors or regions.

ii) Describe different other situations in everyday life that explain inequality in developments between or among people, areas, sectors or regions.

iii) What causes such situations in an economy.

Facts

Meaning of dual economy

A dual economy is one where there is co-existence of two contrasting sectors one advanced and modern and the other backward and traditional, one superior and the other inferior, one desirable and the other undesirable within the same setting. These contrasting sectors both live alongside each other day in day out. They are important to the economy since they help in linking different sectors and secondly the advanced ones tend to pull the backward.

Features of a dual economy

1. Different sets of conditions, of which some are "superior" and others "inferior", can coexist in a given space. Examples of this element of dualism include Lewis's urban and rural sector dualism, the coexistence of wealthy, highly educated elites with mass of illiterate poor people; and the dependence notion of the coexistence of powerful wealthy industrialised nations with weak, impoverished peasant societies in the international economy.
2. This coexistence is chronic and not merely transitional. It is not due to a temporary phenomenon, in which case time could eliminate the

discrepancy between superior and inferior elements. In other words, the international coexistence of wealth and poverty is not simply a historical phenomenon that will be rectified in time.

3. Not only do the degrees of superiority or inferiority fail to show any signs of diminishing, but they even have an inherent tendency to increase. For example, the productivity gap between workers in developed countries and their counterparts in most LDCs seem to widen with each passing year.
4. The interrelations between the superior and inferior elements are such that the existence of the superior elements does little or nothing to pull up the inferior elements let alone "tickle down" to it. In fact it may actually serve to push it down-"to develop its underdevelopment"; (Hans Singer 1970:60-61.).

Other notable features include the following

- Commercial versus subsistence production.
- Modern versus rudimentary/ traditional technology.
- Small scale production versus large scale production.
- Barter exchange versus monetary exchange.
- Formal sector versus informal sector.
- Rural versus urban.
- Educated versus the uneducated.
- Production for home consumption versus production for foreign markets.

Forms of dualism

1. Sectoral dualism

This shows the co-existence of two sectors one developed while the other is backward. For instance, industry and agriculture, rural and urban among others. These sectors though different in size and nature, work hand in hand through linkages. Some supply raw materials while others supply tools like machines. They therefore have to live along side each other for their survival.

2. Economic dualism

This shows existence of two economic categories in society for example the rich and the poor. The rich can be seen in society living alongside the poor. The rich provide employment to the poor to improve their living standards. Apart from the social life, economically there is a discrepancy between and among economic ventures where some are financially well off with big infrastructure while others are finally poor depending on stipends to survive.

3. Technological dualism

This involves backward technology which is mainly labour intensive and used in rural areas and modern technology that is capital intensive used in modern sectors. Normally the big firms use modern technology while the small firms use the backward technology they can afford.

4. Intra-sector dualism

This involves differences within the sector. For example, in the agricultural sector, we have both commercial agriculture and subsistence production and these have different contributions and roles they play in an economy.

5. International dualism

This involves different economies in the world whereby some economies are more developed than others. These developed economies are the ones that help the developing ones through foreign aid and grants.

6. Regional dualism

This involves regional inequalities where some regions are more developed than others leading to both rural and urban regions. Regional dualism has played a high role in encouraging rural urban migration. The developed regions with good infrastructure and jobs, have attracted young productive labour from other regions. This has led to the backward regions lagging behind since its labour is constantly on the move.

Causes of dualism

There are many causes of dualism some of which are discussed below.

- Differences in distribution of resources, for instance some regions have more resources than others hence they develop faster than others.
- Differences in social and economic infrastructure like roads to ease the transportation of goods and services from one area to another. This makes some regions to develop faster than others.
- Government policies like a regressive tax which taxes the poor more than the rich cause some people to become poor while others become rich.

- Historical factors e.g. one can get much income because of inheriting property from rich parents. In rural areas, most people become rich because of inheriting land. Those with poor backgrounds have always remained poor.
- Differences in natural abilities, for example when one is physically handicapped. He/she is likely to have little income than one who is physically well and able hence causing income dualism.
- International dualism basically is caused by some countries having passed through the development stages earlier than others. This made them leave the rest behind.
- Intra-sectoral dualism is caused by development part of the sector faster than others. Still different approaches are adopted such as commercial farming rather than subsistence farming.
- Sectoral dualism is caused mainly by discrimination among the sectors where by the government decides to put more emphasis on some sectors while others are left behind. This is more so when looking at the industry versus the agriculture sector.
- Technological dualism is mainly caused by technology transfer and development in some sectors while in other sectors, they still use the traditional technology which has outdated tools.

Advantages of dualism

Dualism is advantageous to the economy in the following ways:

- Linkages can develop between the developed sectors and the underdeveloped sectors and also within the same sector.
- International dualism helps some poor countries to access aid and assistance from the developed nations and also through trade, the underdeveloped countries are able to access foreign exchange.
- Income is in hands of few people who can invest it and produce commodities for other people.
- It encourages the poor to work hard so as to survive.
- The rich can invest in research and innovations and improve technologies.
- The few rich employ the poor in the different activities that may not be done by the rich people.

- More tax revenue is realised by taxing the rich and the developed sectors in the economy.
- Developed technology can lead to the development of the local technology in the country and this can be through innovation and invention.
- Foreign exchange in earned by rich export firms compared to the ones that produce for home market.

Disadvantages of economic dualism

Despite its advantage, dualism has got some demerits some of which are shown below:

- It brings income inequalities since there are two groups of people and the rich and this at times creates tension and mistrust in the society.
- Regional inequalities create regional imbalances in the development and this causes people to move to different developed areas creating the unemployment problem.
- Exploitation of the poor since the sellers may have an assumption that all people have high incomes so they may end up charging them high prices as well.
- Misallocation of resources since the rich people tend to spend on luxurious commodities that may not be very important.
- There is social unrest between the rich and the poor. The poor tend to see themselves as inferior and so they tend to feel neglected.
- Low revenue is collected since there are few people capable of paying tax revenue to the government because of a narrow tax base.
- Policy implementation becomes difficult because the government has got little sources of income and also some sectors are lagging behind others.
- Government planning becomes hard because the plans drawn may not be able to cover all sectors. The government has to make partial plans for the different sectors and regions since there are imbalances.
- It increases rural urban migration due the difference in the developments. People will tend to move to urban centres where there are good social services.

13.3 Economic Dependence

Activity 3

(i) It is stated, from the above case study in activity 1 of this unit that, "the economy is based mostly on subsistence agriculture with coffee and tea as her major cash crops for export." What economic term is given to Rwanda's reliance on agriculture for her livelihood or external market for her agriculture output

(ii) One of the features of Rwandan economy shows that, Rwanda is a country of few natural resources. Where then does she get the required resources to meet her development programmes?

(iii) If she continuously relies on such sources for her livelihood, analyse the likely impact on her economy's development trend.

(iv) iv) How best can the government of Rwanda get out of such a trap of relying on other sources than her own homemade solutions?

Facts

Meaning of economic dependence

Economic dependence is the reliance of an entity/ party/ individual on another for resources and decisions. Or it can be defined as the reliance of an economy entity/ individual or party on specific economic activities/ sectors for economic livelihood and development. Or it may be defined as the reliance of a country on another. Most developing countries depend on developed countries.

According to the dependence theory, the developing countries have continued to be backward because they tend to look at and wait for assistance from developed nations. Worse still, developed nations tend to dictate and interfere with the politics of the developed nations. If developing countries want to move steps a head, they need to become self sustaining and put their own ideas in practise other than waiting for developed nations. The economy is dependant in the following ways.

1. Sectoral dependence: This involves dependence on a few sectors like agriculture, industry, mining etc. This creates imbalances in sector developments and worse still a country may move into a dilemma in-case one of the sectors fail.
2. Trade dependence: This involves dependence on exportation and importation of goods and services. Exportation may bring in increased foreign exchange while importation may lead to imported inflation. This may worsen the balance of payment problem of the country.
3. Direct dependence: This involves dependence on foreign decisions and may make the country take up decisions that may not be appropriate to the country.
4. External resource dependence: Dependence on foreign status, expatriates, technology, military hard ware etc. This also limits development of local technology and also the foreign experts are too expensive to pay.

Causes of economic dependence

There are many causes of economic dependence some of which are discussed below:

- High population growth rate creates a gap in the social services and essentials needed by the people hence the solution is to seek aid.
- Low technology development creates a technology gap in the country and this leads to the need to import foreign technology which also comes with its associated problems.
- Occurrence of catastrophes like floods, famine, landslides and drought among others. The government may not be prepared for them and so seek help by depending on other countries.
- Wide spread poverty among the population creates income gap so the government to cover the gap, has to resort to seek aid from other countries.

- Low tax base due to the few economic activities that are carried out. These activities cannot raise enough revenue needed by the government so it has to constantly depend on other countries for assistance.
- Poor education policy that has tended to create more job seekers than creators. People lack the necessary skills to perform hands on. This causes the government to seek for foreign experts.
- Low level of industrialisation has made the country to depend on sectors that don't involve manufacturing. This explains the reason for constant depending on the agriculture sector.
- Inadequate foreign exchange due to the low quality exports and also the low bargaining power at the world market. The country does not get enough foreign exchange and so resort to dependence on foreign countries for assistance.

Advantages of economic dependence

Dependence is advantageous as shown in the reasons discussed below:

- Dependence helps to increase a country's resources, this helps it to meet its deficits especially in the national budget.
- Dependence helps a nation to alleviate the effects of catastrophes. Calamities like landslides, earth quakes and floods normally leave nations in a helpless state.
- Dependence helps to close the manpower gap which is prevalent in developing countries. The skilled manpower that is inadequate in LDCs is covered by the manpower aid from developed nations.
- It improves on the technology gap in developing countries; dependence on foreign technology and other equipment from developed countries improves upon quality of output and production methods in developing LDCs.
- Dependence increases employment opportunities to people in LDCS. Direct investment aid employs people of developing countries and indirectly to people who construct the investment.
- It closes the foreign exchange gap in developing countries. Financial aid extended to LDCs is in form of foreign currencies increases the foreign exchange reserves in developing countries hence developing them.

- Sectoral dependence helps the nation to carry out more research aimed at developing that particular sector in terms of quality and quantity.
- Dependence on trade creates market for the home made goods hence leading to foreign exchange inflow, still the economy gets what it can not produce from outside.
- Dependence strengthens relationship between the depending country and the one that provides assistance. This creates swift flow of economic activities and ideas between the two countries.

Disadvantages of economic dependence

Facts

Despite the numerous advantages, dependence suffers demerits as shown below:

- Dependence on a few sectors like agriculture may make the country lose foreign exchange during periods when the sectors fail because of unavoidable circumstances like failure of rains.
- It worsens the debt servicing problem; loans contracted must be paid back and on several occasions with interest. This drains the national resources and deny nationals essentials.
- Dependence leads to high balance of payment deficits. The high out flow of resources to pay back loans and service them worsens the balance of payment position of the country.
- Sometimes the technological assistance given is inappropriate, it may be too underdeveloped or beyond the standards of developing countries, so it may just be wasted.
- Sometimes the pre-conditions set for foreign aid are disastrous for the country. Countries may be forced to devalue their currency, retrench workers or even accept anti social inhuman acts like homosexuality etc. in order to receive their aid.
- Dependence on aid is sometimes tied to unproductive projects like digging boreholes in rural areas, financing wars. Paying back is difficult since such projects do not bring monetary returns.

- Dependence slows down initiative and hard work. Citizens of developing countries become lazy expecting to live on aid.
- Dependence distorts planning and plan implementation of developing countries because the recipient country is not sure when the aid will come.
- Dependence reduces local production as people expect to live on foreign imported goods. This retards economic growth of nations.

Measures to reduce economic dependence

Below are some measures that can be undertaken to reduce dependence:

- Diversification of the economy so as to have a variety of goods and services will reduce depending on other countries for goods.
- Training of labour force through seminars and workshops to reduce depending on foreign experts.
- Developing and promoting local intermediate technology so as to reduce depending on foreign technology which is expensive.
- Encouraging savings and investment by putting in place a good investment climate that will attract investors to produce more goods and services.
- Proper planning to ensure that the different sectors of the economy are planned for to avoid inconveniences during times of disaster.
- Promoting import substitution strategy to produce goods that were formally imported so as to stop depending on imports.
- Improvement on the political climate so as to encourage production of goods and services so as to increase the national output.
- Diversification of the markets so as to increase export earnings.
- Controlling population growth to reduce exerting pressure on the few resources and underdeveloped sectors so that the government may not solicit for food aid.
- Promoting of initiatives that encourage the consumption of home made products so as to limit depending on imports.

13.4 Structure of Trade (exports and imports)

Activity 4

Undertake research from the library or the internet about the structure of Trade & answer the questions that follow.

(i) Describe the structure of trade in Rwanda.

(ii) How has such a structure affected the development of Rwanda's economy?

Meaning of structure of trade

Structure of trade refers to the nature of exports and imports, contribution of trade to national income, composition of exports and imports among others. Normally, the nature of exports is low quality and charged low prices and imports are basically high quality and expensive.

Structure of trade in Rwanda:

Rwanda's economic policy is open to foreign trade which accounts for 51.5% of the GDP. In addition to benefiting from the U.S.-Rwanda Bilateral Investment Treaty (BIT), which entered into force in 2012, Rwanda is a member of the East African Community (EAC) - one of the most dynamic regional communities in Africa - the Common Markets of Eastern & Southern Africa (COMESA) and the WTO. Custom duties are relatively low in the country (7.3% on average) and non-tariff barriers are virtually non-existent.

Rwanda mainly exports petroleum oils, gold, tea and coffee, while imports are led by pharmaceutical products, radio-telephony transmission tools and cement. The country's leading trading partners are the neighbouring Democratic Republic of Congo (31.8%), Kenya (16%), the UAE (14%) and Switzerland (8.8%); with imports coming chiefly from China (21.2%), followed by Uganda (11.2%), Kenya (7.8%) and India (7.4%).

Due to its strong growth and demand for manufactured goods, Rwanda has a structural trade deficit. After narrowing in 2017, the deficit increased in 2018, from USD -829 million to USD -907 million (World Bank, 2018). In

2018, merchandise imports from Rwanda reached USD 2.58 billion, while exports amounted to USD 1.1 billion. The country exported services worth USD 798 million and imported USD 931 million (WTO, 2018). This can be further elaborated in the tables below.

Foreign Trade Values	2014	2015	2016	2017	2018
Imports of Goods *(million USD)*	2,563	2,570	2,293	2,323	2,518
Exports of Goods *(million USD)*	723	659	744	1,050	1,126
Imports of Services *(million USD)*	397	427	1,062	904	931
Exports of Services *(million USD)*	325	352	851	729	798

Source: World Trade Organisation (WTO) ; Latest available data

Foreign Trade Indicators	2014	2015	2016	2017	2018
Foreign Trade *(in % of GDP)*	47.6	52.5	48.0	51.0	51.5
Trade Balance *(million USD)*	-1,269	-1,237	-1,310	-829	-907
Trade Balance (Including Service) *(million USD)*	-1,335	-1,562	-1,570	-986	-1,069
Imports of Goods and Services *(Annual % Change)*	14.6	34.8	-1.1	10.1	9.4
Exports of Goods and Services *(Annual % Change)*	7.2	6.3	12.9	33.6	0.8
Imports of Goods and Services *(in % of GDP)*	32.9	38.3	33.1	32.8	34.1
Exports of Goods and Services *(in % of GDP)*	14.7	14.2	14.9	18.2	17.4

Source: World Bank ; Latest available data

Main Partner Countries

Main Customers *(% of Exports)*	2016	Main Suppliers *(% of Imports)*	2016
Kenya	16.0%	China	21.2%
United Arab Emirates	14.0%	Uganda	11.2%
Switzerland	8.8%	Kenya	7.8%
Singapore	3.2%	India	7.4%
United States	3.0%	United Arab Emirates	5.8%

Source: Comtrade, 2020. Because of rounding, the sum of the percentages may be smaller/greater than 100%.

Main Products

0.6 bn USD of products exported in 2016	
Petroleum oils and oils obtained from bituminous...	17.4%
Gold, incl. gold plated with platinum, unwrought...	12.8%
Tea, whether or not flavoured	11.8%
Coffee, whether or not roasted or decaffeinated;...	9.6%
Niobium, tantalum, vanadium or zirconium ores and...	6.4%
See More Products	42.0%

1.8 bn USD of products imported in 2016	
Medicaments consisting of mixed or unmixed...	4.1%
Transmission apparatus for radio-telephony,...	3.5%
Cement, incl. cement clinkers, whether or not...	3.2%
Motor cars and other motor vehicles principally...	3.1%
Cane or beet sugar and chemically pure sucrose, in...	3.0%
See More Products	83.1%

Source: Comtrade, 2020. Because of rounding, the sum of the percentages may be smaller/greater than 100%.

Main Services

0.7 bn USD of services exported in 2015	
Travel +	44.51%
Government services	35.14%
Transportation +	13.12%
Communications services	3.05%
Construction services +	2.67%
Financial services	1.12%
Other business services +	0.39%

0.9 bn USD of services imported in 2015	
Transportation +	52.72%
Other business services +	17.89%
Government services	16.02%
Travel +	10.68%
Communications services	1.33%
Construction services +	1.28%
Financial services	0.08%

Source: United Nations Statistics Division, 2016.

Characteristics of structure of trade

- Exports are mainly raw materials such as coffee, and the imports are manufactured goods like computers and cars among others.
- Export earnings are low while expenditure on the imports is high hence balance of payment problems.
- The exports are similar to those of other countries and this leads to floating at the world market hence low earnings. Most of the countries export coffee, cotton, tea among others.
- The export- import exchange is unbalanced because LDCs export low value items and import high value goods.
- Most of the trade is with the colonial masters however because of integration, the trend is changing to trading with a variety of countries.
- The export of manufactured products is limited in LDCs due to low levels of technology, low manufacturing capacity etc.
- Export promotion industries are mainly owned by foreigners meaning that profit repatriation is likely to be high. Examples of these are Azam, Matella Dodoma among others.

Consequences of such a structure

- Persistent balance of payment problems arising from import value exceeding export value.
- Because of low exports, the forex earnings are low and this hinders the speed of development.
- The terms of trade are constantly deteriorating because of high prices for imports and low prices for exports and this has led to constant unfavourable terms of trade.
- There is likely to be excess capital outflow because most of the export promotion industries are owned by foreigners.
- Because of exporting similar commodities with other countries, there are low earnings expected because of too much at the world market.
- Trading mostly with the colonial masters limits the markets for the exports and at the same time limits getting a variety from other countries.
- There is a narrow market and this limits bargaining power and possible earnings from exports.

13.5 Subsistence Sector

Activity 5

Analyse the case study below and answer the questions that follow.

Case study:

The Rwandan economy depends on the subsistence economy, tea and coffee exports and tourism. The mining sector is also a pillar of the economy: the country is one of the largest producers of tantalum, used among other things in the construction of mobile phones. Agriculture is the main economic activity of the Rwandan people, directly providing employment for two-thirds of the total population (World Bank), but more than 80% of the population lives on subsistence agriculture. The sector accounts for 29% of GDP and accounts for around 80% of foreign income from exports of coffee, tea, hides and skins, horticulture and pyrethrum (chrysanthemum-based insecticide). About 61% of the Rwandan soil is suitable for agriculture because the soils are fertile, but food production often does not meet demand, requiring imports.

Required:

(iii) With reference to your, from where do the households get their basic necessities, especially food?

(iv) Basing on the case study above, what do you understand by the term subsistence sector?

(v) Describe the features of such a sector in Rwanda.

(vi) Assess the contribution of the subsistence sector to the development process of Rwanda.

Facts

Meaning of subsistence sector

Subsistence sector covers the biggest part of the economy where most of the production is for home use and little or incidental surplus is sold off to meet the basic needs of life. Subsistence sector may basically apply to agricultural output and small scale industrial output. The sector basically relies on natural resources as inputs and family labour is used. There are no surpluses since it is done on a small scale. The incidental surpluses if any are taken to local markets.

Characteristics of the subsistence sector

- Dependence on family labour during the production of goods.
- Low productivity of labour due to the poor methods of production.
- There is lack of specialisation i.e. people grow a variety of commodities.
- Predominant system of exchange is barter which limits economic growth.
- Limited scientific methods of production e.g. limited use of fertilisers.
- The major aim is to produce for minimum survival and to avoid famine.
- Predominance of communal land tenure system as opposed to individual land system.
- Production is influenced by social attitudes and beliefs.

Advantages of subsistence sector

The sector is of great importance in the following ways:

- Little marketing is needed since most of the food is for home consumption and only the incidental surplus is sold.
- Subsistence sector is easily managed. This is because output is small and it employs few workers during the production process.
- There is little or no wastage. This is because production is done on small scale and bases on the size of the family.
- Variety is grown and kept. This helps the people to have a balanced diet which can save them from problems like malnutrition.
- Little losses are incurred if there are fire outbreaks. This is because the crops are grown on a small piece of land.
- It requires little capital which can be afforded by most of the people for buying simple tools and inputs.
- It does not need to hire and employ many workers since mostly family labour can be used during the production process.
- It is normally owned by sole proprietors who may be able to make decisions independently and quickly.

Disadvantages of subsistence sector

The demerits of the sector are discussed below:

- Firms don't enjoy economies of scale. This is because they produce on a small scale and their output is low.
- Little incomes are earned by the farmers because they are basically on low scale and for home consumption.
- It retards development of the agriculture sector since simple tools are used and scientific methods are not embedded so much.
- Low quality is produced since simple tools are used and poor farming methods are used.
- Mechanisation is not possible since agriculture is carried out on small fragmented plots.
- Little or no government revenue is collected because of low output and only the incidental surplus is taken to the market.
- There is underutilisation of resources such as land due to small scale production and this may lead to low productivity.
- Specialisation is not normally possible under small scale farming and this limits the improvement of the quality that may be produced.

13.6 Informal Sector

Activity 6

Analyse the photos in figure 3 below and answer the questions that follow.

Figure 3: Informal sector activities in Rwanda

Required:

(i) Identify the activities taking place in each of the above photos.

(ii) Describe what you think are the common features of the activities in the above pictures.

(iii) Identify other activities in Rwanda that have similar features.

(iv) In your own view how important are these activities to the economy.

(v) What problems do they normally face in their day to day activities?

(vi) What do you think can be done to improve the economic activities of those involved in such businesses?

Facts

Meaning of informal sector

Informal sector is an intermediate sector existing between the traditional and the modern sector comprised of the self-employed. Examples of the informal sector include tax washers, tax operators, charcoal sellers, road side sellers, brick making, salons etc. The sector is of great importance to the economy since it employs a variety of people.

Characteristics of the informal sector

- Informal sector mainly produce on small scale because of the low capital employed.
- They mainly use poor or simple technology since they cannot acquire modern developed machines.
- They produce mainly low quality goods since the machines they possess cannot produce good quality output.
- Informal sector is dominated with poor or no record keeping mainly because they are done on small scale.
- It is basically sole proprietorship meaning they are owned by single individuals and most owned by families.
- It is dominated by semi-skilled or unskilled personnel.
- They use basically local resources that are provided naturally.
- They basically produce for the local market since they cannot produce to feed the entire external market.
- Business is operated in open and semi-permanent structures that can easily be demolished and the business transferred to another location.

Advantages of informal sector

The informal sector is advantageous in the following ways:

- Informal sector creates employment opportunities since it is labour intensive technique and this reduces income distribution.
- It produces essential goods that are beneficial to low income earners.
- It provides training grounds for growth of entrepreneurs.
- It provides revenue to the government through taxation of the business activities.

- It grows to pave way for transformation into a modern dynamic sector.
- It promotes development of appropriate technology which suits the resources of the country.
- It promotes linkages in production i.e. forward and backward and this leads to achievement of an integrated economy.
- It promotes the spirit of self-sustenance there by reducing the prevailing dependence on simple consumer products.
- It paves way for the development of small scale industries through innovations and inventions carried out.
- Informal sector widens consumer choice since it produces a variety. This is because there are many producers working under the informal sector.

Disadvantages of informal sector

Despite its numerous advantages, the sector also has disadvantages:

- There is wasteful competition leading to duplication of goods and services and wastage of resources.
- There is pollution and its effects to the environment leading to degradation and hindering development.
- It leads to public revenue instabilities since production cannot be relied upon and also there is high rate of tax avoidance and evasion.
- It causes congestion in the semi-urban areas with its associated problems like prostitution, slums, theft etc.
- It leads to underemployment and unemployment hence labour capacity to produce goods is not fully put to use.
- It produces at excess capacity and end up exploiting consumers through high prices.
- It produces low quality goods and this leads to low standards of living of the people and low income earnings.
- There are high administrative costs on the side of the government and this leads to increased government expenditure.

13.7 Private Sector

Activity 7

Basing on the case study and image below, undertake research on Private sector in Rwanda, and answer the questions that follow;

Figure 4: PSF logo.

Case study:

Private sector development is one of GoR's key development strategies transitioning from an agrarian society to an economy led by the private sector. The Government of Rwanda has put private sector development at the forefront of poverty reduction and economic transformation since 2000 as one of its strategies for attaining middle-income status. The country consequently adopted the private sector development strategy in 2013 to address key constraints in private sector development including high costs of energy and access to finance and entrepreneur deficits particularly among small and medium enterprises (SMEs). Supporting the private sector to become the engine of growth is the core objective of most development partners in the country. SME development has had a big impact on unlocking the contribution of Rwanda's private sector to inclusive growth, job creation and poverty reduction. The share of private sector investments which was 10 per cent in 2010 increased to 13 per cent in 2016 and many government strategic interventions which will enable the private sector to get a dominant share of investments through private-public partnerships are underway.

Required:

(i) Which organization in Rwanda uses the above logo?

(ii) Cite some of the enterprises in your locality that work under such an organisation.

(iii) With reference the case study above, what is described as a private sector?

(iv) Describe features of a sector under which the enterprises given in (ii) work.

(v) How have such enterprises contributed to the development of the areas they operate from and the entire nation at large?

(vi) What normally hampers their effective operation? .

Facts

Meaning of the private sector

Private sector is an area of production activities not mainly controlled by the government. It may include the informal sector, farmers, self-employed among others. The private sector is very active in a free market economy and mixed economic system as compared to the command of the economic system. This is because most of the resources are owned by the companies and individuals which and who are free to take all the economic decisions like how to produce, when to produce, for whom to produce, etc with no government intervention. The government simply comes in to carry out regulations during the production process.

The sector has become more vibrant due to the formation of the private sector federation-Rwanda (PSF) in 1999 replacing the former Rwanda chamber of commerce and industry. The PSF is a professional organisation dedicated to promote and represent the interest of the Rwandan business community. It is an umbrella organisation that groups professional chambers, such as

- Chamber of agriculture
- Chamber of commerce
- Chamber of art and crafts
- Chamber of finance

- Chamber of ICT
- Chamber of industry
- Chamber of liberal professional
- Chamber of tourism
- Chamber of women entrepreneurs
- Chamber of young entrepreneurs.

Characteristics of private sector

- It is mainly operated on a small scale.
- It is dominated by individual producers (sole traders).
- It is mostly produces primary products.
- It is characterised by high levels of competition.
- It is driven by profit motive.
- Mainly it produces consumer goods and a few producer goods.
- Mainly it uses labour intensive techniques of production.
- It is mainly active in urban centres than rural areas.

Role of the private sector to development

The sector is very important to the economy due to the roles discussed below

- It employs majority of the people hence reduce unemployment and this increases incomes and standards of living.
- It produces goods and services hence contributing greatly to national income after the sale of the goods.
- It promotes gradual growth of the economy since it stimulates entrepreneurship which leads to discovery of new techniques of production.
- The sector contributes to the growth and modernisation of industry in the country through mobilising of private savings, stimulating consumption and investment.
- The sector helps in exploiting the local resources hence reducing excess capacity that exploits consumers through high prices.
- The private sector uses local resources hence reducing foreign expenditure or resources and raw materials.
- It contributes to government revenue through taxation of the people, structures and also the profits of the businesses.

- The sector re-invests (ploughs back) profits hence expanding the existing productive capacity which increases economic growth and the size of the national income.
- Technological development is enhanced as the sector is innovative and adopts new techniques to suit the changing consumer tastes.
- The sector helps to reduce the subsistence sector by monetarising of majority of the economy.
- It enhances infrastructure development because of its tremendous expansion and this further leads to the development of the country.

Challenges of the private sector

Though the sector employs majority of the people, it faces numerous challenges that hinder its operations. Some of these are shown below:

- High taxation by the government. The government sometimes taxes them highly hence they have high operation costs that limit their expansion.
- Underdeveloped infrastructure like roads limits their movements from their production sites to the markets. This sometimes cause losses to them.
- Inadequate market both within and outside. This is because of the low quality of the goods that are produced and worse still they produce similar goods that create surplus at the markets.
- The technology is still low and this has continuously led to low output and low revenues.
- Because of competition, most of them produce similar products hence calling for high advertisement costs which lead to increased cost of production. The inefficient firms are sometimes driven out of the business leading to unemployment.
- Low prices paid by the consumers. This is sometimes due to price legislation by the government. The firms earn low profits that don't enable them to develop.
- Underdeveloped structure for production. Some of the firms under the private sector don't have permanent markets so they don't have a developed structure of production. This has sometimes led to overproduction and wastage of resources.

- Inadequate capital for production. This is the major problem that the private sector faces. Some have few equipment that cannot enable them to get loans from the banks hence their businesses have constantly not changed from small scale to large scale.
- Low levels of skills of the entrepreneurs has led to low innovations and inventions leading to low quality outputs and low profit.

Achievements of the private sector

Despite the challenges discussed above, the sector has been able to have many achievements geared towards development of the economy:

- The sector has contributed to government revenue through taxation of the people, structures and also the profits of the business.
- The sector re-invests (ploughs back) profits hence expanding the existing productive capacity which increases economic growth and the size of the national income.
- Technological development has been enhanced as the sector is innovative and adopts new techniques to suit the changing consumer tastes.
- It has helped to reduce the subsistence sector by monetarising of majority of the economy.
- Infrastructure development has tremendously expanded and this further leads to the development of the country.
- The sector employs the majority of the people hence reduce unemployment and this increases incomes and standards of living.
- The sector produces goods and services which contributes greatly to the national income after sale.
- It promotes gradual growth of the economy since it stimulates entrepreneurship which leads to discovery of new techniques of production.
- The sector contributes to growth and modernisation of industry in the country through mobilising of private savings, stimulating consumption and investment.
- The sector helps in exploiting the local resources hence reducing excess capacity that exploits consumers through high prices.
- The sector uses local resources hence reducing foreign expenditure or resources and raw materials.

Weaknesses of the private sector /negative role of the private sector to development

Facts

Apart from the achievements shown above, negatively the sector has slowed down development of the economy in the following ways:

- Private sector is mostly located in urban centres hence cause rural urban migration with its associated problems like theft, prostitution and slum development among others. These problems retard development.
- Tendency of using capital intensive techniques to increase production leads to unemployment with its associated problems like poor standards of living. etc.
- It tends to specialise in few activities leading to consumer exploitation in form of high prices since sometimes they become monopolies with no competition.
- Private sector concentrates on small scale production activities and this may not enable it to generate adequate economies of scale.
- The use of rudimentary/ outdated technology limits production hence little output for the growth of the country.
- The sector is profit motivated hence it may not provide services that are good for the society but non-profit making.
- Capital outflow may occur if the productive ventures are owned by foreigners and thus the country may lose foreign exchange.
- Limited levels of diversification due to production of similar commodities causes the consumers not to get a variety of commodities.
- Production of low quality goods may fetch little when exported hence low foreign exchange.
- Income inequalities may arise where a few people get engaged in such activities and this may create tension in society and underdevelopment of some regions.

Policies adopted to encourage/ promote the private sector

In capitalist economies, there is a need for a strong and vibrant sector and the IMF and World Bank too call for a private sector run economy since it helps reduce the expenditures of the government and government basically provides the supervisory role. A strong private sector needs to be developed and below are some of the policies that can assist in attaining that objective.

- Provision of both economic and social infrastructures such as roads, power, water supply etc.
- Trade liberalisation where entry into a particular field is not restricted
- Government has tried to maintain security and political stability.
- Economic incentives like subsidisation policies, tax holidays, etc. have been encouraged by the government to promote investments.
- Relaxing the procedures followed when opening up businesses to encourage private investors.
- Price stabilisation in the market has created confidence in the private sector and this has increased their participation in the production.
- Inputs especially to the farmers have been given to encourage their activities.
- Consistent and uniform application of government policies aimed at ensuring fair and equal treatment among the private, foreign and state owned enterprises.
- Respect of contracts provided to the private investors and protection of property rights.

13.8 Public Sector

Activity 8

Visit the library or the internet, research about public sector in Rwanda and thereafter, share your findings in class about the following.

a) Write the following in full.

   i) RURA.

   ii) RSB.

b) Based on their operation, under what sector would you categorize them?

c) Identify other organisations or enterprises in Rwanda that fall under such a category as the above mentioned.

d) What are the distinguishing features of the sector given in (b) above?

e) Assess the contribution of such a sector towards national development of our country.

f) What hinders their effective effort towards spearheading Rwanda's development process?

Facts

Meaning of public sector

Public sector is part of the economy owned and operated by the government. The government owns and carries out the major economic decisions. Government enterprises include, public corporations/enterprises which provide specific services for free or reduced prices, government parastatals which are non-profit making and local authorities which provide essential services. Rwanda's public appears to be the main focus of much of the capacity building support in the country. In Rwanda's public sector, significant resources are being devoted to human resource development inform of short term training seminars and workshops. The sector is very important to smooth governing and development of the Rwandan economy at large.

Characteristics of the public sector

- Development oriented i.e. it aims at developing the nation.
- It is characterised by bureaucracy and red tape. This involves a range of procedures so as to achieve what someone wants.
- Normally it takes on projects which require large capital that cannot be taken up by the private sector.
- Medium and large scale industries dominate.
- It employs a large size of the population however with the present trend, its contribution is reducing.
- It is normally organised on monopoly basis as it provides services which are vital to the people.
- It involves high levels of external influence in decision making and implementation of the plans since foreigners fund the projects.
- It has limited flexibility as it is for private sector in the production of goods and services.

Objectives of the public sector

- To create employment for the people so as to reduce the problems associated with unemployment.
- Provision of goods and services at reduced prices since the public sector does not aim at profit maximisation but welfare maximisation
- To ensure equitable income distribution so as to have balanced development.
- To provide public utilities that don't yield profits such as defense, water and sanitation among others.
- To regulate the activities carried out in the country and this is mainly done by the central government.
- To bring competition with the private sector for efficiency through reducing monopoly powers.
- To develop the economy through planning and plan implementation which may be both short term, medium and long term plans.
- To take up projects that cannot be done by the private sector because they may require large amounts of capital and at the same time they may be non-profit generating.

Justifications of the public sector

- It is composed of manufacturing industries which are fundamental in reducing imports hence reducing the balance of payment problems.
- The sector is composed of parastatals which provide goods that are vital to the society.
- It provides a means through which the government promotes equitable distribution of income and this is through public spending on social economic activities.
- It avoids duplication and wastage of resources since it is the sole producer.
- The sector takes on risky projects which the private sector is unwilling to take on.
- It provides services which are vital to the society but are non profit generating and which cannot be provided by the private sector.
- It influences the private sector by working hand in hand in some activities through privatisation and cost sharing.

- The sector is responsible for the welfare of the people and development of the economy as a whole.

Role of the public sector in the country

Facts

Below are some of the roles of the public sector towards development of the economy:

- Provision of essential goods and services like national defense, health, education to bring about development.
- Ensuring fair income distribution and social justice among the citizens by protecting them from private monopoly and fair income distribution.
- Allocation of resources through proper planning especially where the private sector has failed to provide.
- Controls economic activities such as exportation, importation, industry distribution and also the activities of the private sector through monetary and fiscal policies.
- Provides favourable environment for economic growth through setting up price stability, political stability among others.
- Negotiation for foreign assistance inform of capital and other foreign assistance needed for development.
- Provision of employment and training of the labour force.
- Creating and maintaining good working conditions within the country and with outside economies through integration and price negotiations.
- Promotion of agriculture development through adoption of strategies like diversification, subsidisation, technology improvement among others.
- Improving the balance of payment position through export promotion, import substitution among others.
- Funding, directing and implementing programmes aimed at improving the economy.

Problems faced by the public sector

Like all other sectors, the public sector also faces many challenges as shown below:

- Limited finance due to narrow tax base and this limits expansion..
- Corruption and embezzlement which has depleted funds which would be invested..
- Persistent inflation in the country increases the cost of production and amount of risks.
- Inadequate skilled manpower due to poor man power training policy has led to dependence on foreign labour which is expensive.
- Foreign influence by external organisations like IMF and World Bank into the activities dictates policies to be followed by the country.
- They have poor management because of heavy government intervention through selecting top management and constant change of officials among others.
- Inadequate infrastructural facilities needed for development like road facilities, telecommunication among others limits coordination of different sectors.
- Bureaucratic red tape slows down decision making and implementation.
- Sector runs a lot of objectives which conflict and in the end there is poor performance due to involvement in unproductive enterprises.
- Limited market both domestic and foreign explains the poor performance of the manufacturing establishment.

13.9 Privatisation

Activity 9

Use the library or the internet and research on the following questions:

(i) Explain the meaning of privatisation and the different types of privatisation.

(ii) What are the advantages and disadvantages of privatisation?

(iii) Examine the problems faced during the privatisation process.

Facts

Meaning of privatisation

Privatisation is the reduction of the role of the state in the national economy while at the same time increasing private ownership and private sector both local and foreign. Or, it refers to the transfer of production assets from state ownership to private ownership. The process aims to create a free and competitive environment in which the private sector can drive the country's economic growth. The process began in 1997 with 94 state owned companies earmarked to go through the privatisation process to ensure the entry of innovative investors who could help increase resource utilisation. The private sector has been the basing of development in many countries.

Forms of privatisation

Privatisation takes various forms

1. De- nationalisation (divestiture)

This involves the sale of all or part of the enterprise owned by the government to private people or the public. Or, divestiture or divestment is the reduction of an asset or business through sale, liquidation, exchange, closure or any other means for financial or ethical reasons. It is the opposite investment. It may also take the form of,

- Total sale
- Joint venture where the government enters into agreement with private firms and individuals
- Abandonment, winding up or liquidation.

2. *Liberalisation (De-regulation)*

This involves opening up entry into activities which were previously restricted to the public sector enterprises only by allowing private sector participation. Or, it is the process of removing or reducing state regulations, typically in the economic sphere. It is the undoing or repeal of government regulation of the economy. This is meant to increase competition and good quality output.

3. *Contracting out*

This is where the provision of the good or service is transferred from the public to the private sector while the government retains the responsibility to supply the good or service. It takes the following forms:

(a) Franchising. This is the right to market on behalf of the government.

(b) Contract management. Here the government owns the property but gives out management like maintenance, providing goods and services among others.

(c) Leasing or renting. Here the government contracts the private sector to provide part of the service or to use/ rent its assets.

4. *Cost sharing*

This is where the government retains ownership of the enterprises but the beneficiaries contribute to the running costs e.g in schools and universities where the government pays part of the fees and the students pay the rest. In healthcare, cost sharing occurs when parties pay for a portion of health care costs not covered by health insurance. The “out of pocket payment” varies among health care plans and depends on whether or not the patient chooses to use a healthcare provider who is contracted with the health care plans network. In Rwanda common health insurance companies include RSSB, Britain, Rediant, Soras, Saham among others.

Reasons for privatisation (rationale)

- To enable firms, operate more efficiently.
- To reduce corruption tendencies in the public sector.
- To attract foreign investments in the economy without fear of nationalisation.
- To reduce government expenditure on public sector enterprises
- Fulfilment of the International Monetary Fund conditionality of a private sector led economy.
- To create more job opportunities in the long run when the private sector expands it enterprises.
- To improve resource utilisation through efficiency of the private sector and the profit motive.
- To allow government concentrate on provision of essential services like health and education.
- To expand the tax base for revenue to the government.
- To encourage competition and improve quality of services offered by reducing monopoly basis.

Advantages of privatisation

Facts

Privatisation is of importance in the following ways:

- It increases efficiency in the sold parastatals leading to good quality goods and services.
- It helps to increase output of the sold firms.
- It reduces corruption and financial mismanagement of the enterprises.
- It reduces the state of the burden of concentrating on the production of essential services.
- It increases revenue to the government realised from the sold enterprises.
- Increased competition results into emergence of several firms providing services which had been monopolised by the state enterprises.
- It has increased private sector confidence in the country.
- It reduces government budgetary deficits.

Disadvantages of privatisation

Despite its importance, the process of privatisation has some disadvantages as discussed below:

- Increased resource outflow by the new owners of the enterprises leads to profit repatriation.
- The government loses property through transactions with dubious businessmen who don't pay but spoil the property.
- Privatisation increases debts to the government because a lot of money is borrowed to fund the process yet little is realised after selling
- Foreigners dominate in the economy as the nationals are reduced in the process.
- There is poor working conditions to the workers inform of low wages, longer hours of work, etc.
- Over exploitation of natural resources causes environmental degradation.
- Associated with low levels of labour absorption in some sectors, underemployment and even reduction of local employment because they bring in foreign labour.
- Over competition leads to use of non-price competition measures which include reduction in weight of goods like bread etc.

Limitations of privatisation

Privatisation process is not very smooth as it sounds, it has got numerous challenges as discussed below:

- Corruption in the privatisation unit i.e. some officials are not transparent and connive with prospective buyers.
- Opposition from the general public often delays the process of privatisation.
- Poor valuation of the enterprises leads to assets being sold at give-away prices.
- Poor states of the enterprises due to poor maintenance making it hard to sale them.
- Political sabotage by opposition leaders sometimes block the sale of enterprises just to frustrate the government and advance their causes .

- Poverty among the nationals makes the enterprises to be sold to foreigners leading to foreign domination in the country.
- Small market discourages potential buyers due to limited potential for expansion.
- Political instability in some parts of the economy discourages potential investors from buying the enterprises.
- Unscrupulous buyers win the bids to buy the enterprises and they end up not paying after taking over the property.
- Underdeveloped capital markets. Government enterprises are sold under a capital market so its underdevelopment limits the potential buyers to access the enterprises.

13.10 Economic Liberalisation

Activity 10

Analyse the case study below and answer the questions that follow.

Case study:

Most high-income countries have pursued the path of economic liberalization in the recent decades with the stated goal of maintaining or increasing their competitiveness as business environments. Liberalization policies include partial or full privatisation of government institutions and assets, greater labour market flexibility, lower tax rates for businesses, less restriction on domestic and foreign capital, open markets, etc. In developing countries however, economic liberalization refers more to further "opening up" of their respective economies to foreign capital and investments with a view of having fastest growing economies Many countries nowadays, particularly those in the third world, arguably were given no choice but to "liberalize" their economies by privatizing key industries to foreign ownership in order to remain competitive in attracting and retaining both their domestic and foreign investments.

Required:

(i) What, according to the case study above, is meant by economic liberalisation?

(ii) Under what circumstances is an economy of a given country said to be liberalized?

(iii) Is the economy of your country liberalized? Justify.

(iv) Why may a given economy decide to liberalize the economy of her country?

(v) Though liberalisation may seem to yield much in terms of economic growth, it hasn't been an easy attempt by some countries. Why?

Facts

Meaning of economic liberalisation

Economic liberalisation is the lessening of government regulations and restrictions in an economy in exchange for greater participation by private entities. The doctrine is associated with classical liberalism. . The introduction of the private sector through economic liberalisation tends to iron out of monopolistic tendencies by public sector through active competition with the government.

Advantages of economic liberalisation

Liberalisation is very essential to the economy because it gives power to the sector to engage in economic activities because of the price mechanism engine. Below are the advantages:

- Trade liberalisation allows countries to specialise in producing the goods and services where they have a comparative advantage (produce at lowest opportunity cost). This enables a net gain in economic welfare.
- Lower prices: The removal of tariff barriers can lead to lower prices for consumers. E.g. removing food tariffs in the West would help reduce the global price of agricultural commodities. This would be particularly a benefit for countries who are importers of food.

- Increased competition: Economic liberalisation means firms will face greater competition from abroad. This would act as a spur to increase efficiency and cut costs or it may act as an incentive for an economy to shift resources into new industries where they can maintain a competitive advantage.
- Economies of scale: Liberalisation enables greater specialisation. Economies concentrate on producing particular goods. This can enable big efficiency savings from economies of scale.
- Removing barriers to international investing: Economic liberalisation process begins by relaxing these barriers and relinquishing some control over the direction of the economy to the private sector. This attracts foreign investors.
- Unrestricted flow of capital: The primary goals of economic liberalisation are the free flow of capital between nations and the efficient allocation of resources and competitive advantages. This is usually done by reducing protectionist policies such as tariffs, trade laws and other trade barriers. One of the main effects of this increased flow of capital into the country is that it makes it cheaper for companies to access capital from investors.
- Stock market performance: In general, when a country becomes liberalised, the stock market values also rise. Fund managers and investors are always on the lookout for new opportunities for profit, and so a whole country that becomes available to be invested in will tend to cause a surge of capital to flow in.
- Diversification for investors: Investors can also benefit by being able to invest a portion of their portfolio into a diversifying asset class. This happens because the country becomes more integrated with the rest of the world and has become more sensitive to events that happen outside the country. A high degree of integration can also lead to increased inflow of investors.

Demerits of economic liberalisation

Despite the advantages, economic liberalisation has some demerits as discussed below:

- Economic liberalisation often leads to a shift in the balance of an economy. Some industries grow, some decline. This may cause structural unemployment when certain industries close. Economic liberalisation can be painful in the short run, because industries and workers suffer when uncompetitive firms decline.
- Economic liberalisation could lead to greater exploitation of the environment, e.g. greater production of raw materials, trading toxic waste to countries with lower environmental laws.
- Economic liberalisation may be damaging for developing economies who cannot compete against free trade. The infant industry argument suggests that trade protection is justified to help developing economies to diversify and develop new industries. Most economies had a period of trade protectionism. It is unfair to insist that developing economies cannot use some tariff protectionism.
- Unbalanced economic sectors; This is because the introduction of the private sector in the business sector creates an increased desire for profit motives. This leads to some sectors that yield in profits to develop faster than those that are non profit making
- Increased dependence: This is because an increase in trade liberalisation makes the economy to shift from an independent one to the one that depends on imports and exports.
- Increased production of undesirable goods that may be harmful to people. The private sector engages in any activity that brings in profits so with little monitoring by the government, there may be production of undesirable products in the economy.

Limitations of economic liberalisation

The process of economic liberalisation has faced numerous challenges of which are discussed below:

- Increased government influence in resource allocation makes companies fail to locate their businesses in strategic areas that are profitable.
- Overtaxation by the government makes the enterprises fail to achieve their intended objectives.
- Price legislation by the government does not allow automatic adjustment between the forces of demand and supply hence profits got are few.
- Need to control some production of public utilities such as defense and water among others limits their liberalisation.
- Nationalisation by the government scares the participants in economic liberalisation. Some firms fail to join due to fear of nationalisation
- Poverty among the people, limits their participation in economic activities even after the government has carried out liberalisation.
- Inadequate manpower or expertise since some sectors may require specific labour. So even after liberalisation, the sectors have continued to be run by sole monopolies.

Unit assessment

1. (i) Rwandan economy is both public and private sector led. Give examples of enterprises that are under private sector and public sector.
   (ii) How important has the private sector been to developing the nation?
2. (i) Sometime selling government property to the private sector seems unavoidable. Why is this so?
   (ii) What major problems are faced by the government when transferring property to the private individuals?
3. (i) Under which group are charcoal sellers and salons classified?
   (ii) What is their contribution to the development of the economy of Rwanda?
4. Most of the agriculture done in Rwanda is on small scale and for home consumption. What are the features of such type of agriculture?

Glossary

- **Contract management**: This is where the government owns the property but gives out management like maintenance, providing goods and services among others
- **Cost sharing**: This is where the government retains ownership of the enterprises but the beneficiaries contribute to the running costs. eg in schools and universities where the government pays part of the fees and the students pay the rest.
- **Community sector**: This is a sector which is neither in the private nor in the public sector but is in hands of the community. Examples of the sector include NGOs, cooperatives and other self employed/ help community development organisations
- **Commercial sector**: This is a sector where most of what is produced is for the market.
- **Contracting out**: This is where the provision of the goods or services is transferred from the public to the private sector while the government retains the responsibility to supply the goods or services.
- **De- nationalisation**: This involves the sale of all or part of the enterprise owned by the government to private people or the public. It can also be called divestiture.
- **Dualism**: This is the co-existence of two contrasting sectors one advanced and modern and the other backward and traditional, one superior and the other inferior, one desirable and the other undesirable.
- **Economic liberalisation**: This is the removal of unnecessary control on economic activities hence giving people the liberty to participate without government controls.
- **Economic dependence**: This is the reliance of an economy on another for resources and economic decisions. OR, It is the

reliance of an economy on specific economic activities/ sectors for economic livelihood and development.

- **Franchising**: The right to market on behalf of the government.
- **Government enterprises**: These include public corporations/ enterprises which provide specific services for free or reduced prices, government parastatals which are nonprofit making and local authorities which provide essential services.
- **Informal sector**: An intermediate sector existing between the traditional and the modern sector comprised of the self employed.
- **Leasing or renting**: Here the government contracts the private sector to provide part of the service or to use/ rent its assets.
- **Liberalisation**: This involves opening up entry into activities which were previously restricted to the public sector enterprises only. It can also be known as de-regulation.
- **Private sector**: An area of production activities not mainly controlled by the government.
- **Public sector**: This is part of the economy owned and operated by the government.
- **Privatisation**: This is the reduction of the role of the state in the national economy while at the same time increasing private ownership and private sector both local and foreign. OR, it refers to the transfer of production assets from state ownership to private ownership.
- **Parastatal organisations**: These are organisations owned by the government and set by the act of parliament to provide specific services but are none profit making.
- **Subsistence sector**: This is a sector where most of what is produced is for home consumption and incidental surplus is exchanged through barter trade to meet the other basics.

Unit summary

- Dualism
    - Meaning and forms
    - Advantages and disadvantages
- Economic dependence
    - Meaning, forms and causes
    - Advantages and disadvantages
- Subsistence sector
    - Meaning, advantages and disadvantages
- Informal sector
    - Meaning, advantages and disadvantages
- Private sector
    - Meaning, characteristics and roles
    - Challenges and achievements
    - Weaknesses and measures to improve the private sector in Rwanda
- Public sector
    - Meaning, objectives and roles
    - Justification for public sector
- Privatisation
    - Meaning, rationale and forms
    - Advantages, disadvantages and limitations
- Economic liberalisation
    - Meaning and advantages
    - Disadvantages and limitations

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