

**COLLEGE OF VETERINARY MEDICINE, ANIMAL RESOURCES & BIOSECURITY
DEPARTMENT OF BIOSECURITY, ECOSYSTEMS & VETERINARY PUBLIC HEALTH
BBLT 3203 MANAGEMENT & ENTREPRENEURSHIP
YEAR 2018/2019 SEMESTER TWO**

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CONSUMER BEHAVIOUR

The study of consumers helps firms and organizations improve their marketing strategies by understanding issues such as:

- The psychology of how consumers think, feel, reason, and select between different alternatives (e.g. between brands, products, and or retailers).
- The psychology of how the consumer is influenced by his or her environment (e.g. by culture, family, signs, media or marketing and advertising channel).
- The behavior of consumers while shopping or making other marketing decisions.
- Limitations in consumer knowledge or information processing abilities influence decisions and marketing outcome.
- How consumer motivation and decision strategies differ between products according to their level of importance or interest that they entail for the consumer.
- How marketers can adapt and improve their marketing campaigns and marketing strategies to more effectively reach the consumer.

Consumer behavior is the study of individuals, groups or organizations and the processes they use to select, secure, use, and dispose off products, services, experiences or ideas to satisfy needs and the impacts that these processes have on the consumer and society. This definition implies that:

- Behavior occurs either for the individual or group (e.g. friends influence what kinds of clothes a person wears) or an organization (people on the job make decisions as to which products the firm should use).
- Consumer behavior involves the use and disposal of products as well as the study of how they are purchased. Product use is often of great interest to the marketer, because this may influence how a product is best positioned or how we can encourage increased consumption. Since many environmental problems result from product disposal (e.g. motor oil being sent into sewage systems to save the recycling fee, or garbage piling up at landfills) this is also an area of interest.
- Consumer behavior involves services and ideas as well as tangible products.
- The impact of consumer behavior on society is also of relevance. For example, aggressive marketing of high fat foods, or aggressive marketing of easy credit, may have serious repercussions for the national health and economy.

There are four main applications of consumer behavior:

- The most obvious is for *marketing strategy*—i.e. for making better marketing campaigns. For example, by understanding that consumers are more receptive to food advertising when they are hungry, we learn to schedule snack advertisements late in the afternoon. By understanding that new products are usually initially adopted by a few consumers and only spread later, and then only gradually to the rest of the population, we learn that (1) companies that introduce new products must be well financed so that they can stay afloat until their products become a commercial success and (2) it is important to satisfy or delight initial customers, since they will in turn influence many subsequent customers' brand choices.
- A second application is public policy. In the 1980s, Accutane, a near miracle cure for acne, was introduced. Unfortunately, Accutane resulted in severe birth defects if taken by pregnant women. Although physicians were instructed to warn their female patients of this, a number still became pregnant while taking the drug. To get consumers' attention, the United States Food Drug Administration (FDA) took the step of requiring that very graphic pictures of deformed babies be shown on the medicine containers.
- Social marketing involves getting ideas across to consumers rather than selling something.
- As a final benefit, studying consumer behavior should make us better consumers. Knowing that a consumer should pay less when buying in bulk than smaller quantities should make us alert to check labels before we buy.

Analysis of Market and Consumer Behavior

Recall that marketing is focused on the market place and consumers. The marketing process therefore should begin with consumer analysis. It is therefore necessary to analyze the market and consumer behavior. The entrepreneur needs to scan the market environment and see what opportunities are available. Information from the market environment will help the entrepreneur make effective marketing decisions.

Understanding of markets involves analyzing the needs of the buyers and creating products and services that would satisfy customers. As an entrepreneur, you can understand the market by asking a number of questions about the market. Information should be collected from consumers as well as from the competitors and the entire marketing environment so as to inform the next marketing strategy.

Checklist for Market Analysis

- ✦ Who are your prospective customers?
- ✦ What is their demographic profile, economic profile, buying power, and other characteristics?
- ✦ What do your prospective customers usually buy?

- ✚ Who exactly buys what?
- ✚ What are their needs and wants? Why? How? When and from where do they buy?
- ✚ Do they buy once a day, weekly, monthly, once in a lifetime etc?
- ✚ Do they buy in the morning, afternoon, evening etc.
- ✚ Who makes or influences the consumer buying decisions?
- ✚ Are the buyers the ultimate users of the product
- ✚ How much do they pay for similar or competing products? How much are they willing to pay for your products?
- ✚ Where are the customers located
- ✚ Are they within your operating area, neighboring district or far?
- ✚ What does your product do for the customers?
- ✚ Why do they like or hate the product
- ✚ Do you have one or several products
- ✚ Do you plan to increase or decrease product width and depth
- ✚ Is the market growing or declining? Are there prospects for future growth
- ✚ Who are your competitors? How good are their products, prices, promotional and distributional activities? What are their strengths, weaknesses and strategies
- ✚ How is the tax regime of the day
- ✚ What are the trends and methods of taxation? What taxes do I need to pay?
- ✚ What are the economic, socio-cultural, political, legal or regulatory and technology factors affecting business operations.
- ✚ The above questions can be answered through and simple market research. Market research involves gathering full information about your likely customers, competition, the industry and general market environment.
- ✚ Without good information about the market, an entrepreneur would shoot into the dark. You need to understand the market so as to achieve your sales target
- ✚ You need to know the consumption and buying patterns and behaviors of your customers. Market research specifically reveals the following:

- ✦ Customers – who are our customers? Are they schools, hotels, army, prison, bars etc.
- ✦ Market size – what is the size of your market? Is it growing or declining or constant?
- ✦ Competition – name and discuss all major competition. Compare your products with the competitors' in terms of quality, price etc.

Customers and Consumers

A customer is the one who purchases and pays for a product or service. Where as a consumer is the ultimate user of the product or service. A consumer may not have paid for the product. E.g. if a farmer sells 50 liters of milk to a milk collection centre or dairy. The dairy is the customer but a consumer is the ultimate buyer who uses the milk for final consumption. The consumer is the one who gets ultimate utility out of the product or service.

Implications for an entrepreneur

The entrepreneur should direct their marketing efforts towards both the consumer as well as customer. An entrepreneur must understand the needs of both the customer and consumer.

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HEALTH & SAFETY IN THE WORK PLACE

What you should know from this topic:

- ✓ Define health & safety at the work place
- ✓ Define occupational hazards
- ✓ Managing health and safety at work.
- ✓ Conducting risk assessments
- ✓ Conducting health and safety inspections and health and safety audits.
- ✓ Occupational health programs, health and safety policies.
- ✓ Communicating the need for better health and safety practices at work.
- ✓ Accident prevention.
- ✓ Health and safety training.
- ✓ Mainstreaming health and safety into organizational policies.
- ✓ Prevention of hazards versus inspecting for hazards.

Definition

Health and safety at work is concerned with protecting employees and other people including customers / clients etc who are affected by what the company produces and does against the hazards arising from their employment or links with the organization.

Safety programs deal with the prevention of accidents and minimizing the resulting loss and damage to people and property thus saving the organization from costly compensation for damages that occur in the work place.

Health and safety is concerned more with systems in the work place than the working environment. Health and safety programs are concerned with the protection against hazards, and their aims and methods are interlinked.

Occupational health programs deal with the prevention of ill-health arising from working conditions and comprise of diagnosis and prevention of health hazards at work or dealing with ill-health or stress which have occurred despite the preventive actions, and occupational hygiene which is responsible for measurement and control of environmental hazards.

To achieve a health and safe work place, elimination (to the maximum extent possible) of hazards to health and safety is the responsibility of everyone employed in the organization as well as those working on short term or contract. The onus falls on management to provide high standards of health and safety at the work place.

Unfortunately the significance of health and safety policies and practices at work is often less prioritized. Managers must take responsibility to prevent accidents and eliminate health and safety hazards so as to minimize suffering to people and loss of property.

The achievement of the highest standards of health and safety in the work place is the moral as well as the legal responsibility of employers.

Close and continuous attention to health and safety is important because ill-health and injuries caused by the system of work or working conditions cause suffering and loss to individuals and their dependants.

Accidents and absenteeism from work due to ill-health or injuries lead to losses and damage to the employer organization although this business reason should be considered secondary to the human reasons.

Accident prevention

- ✓ Identify the common causes of accidents and conditions under which they are most likely to occur.

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Accident prevention

- ✓ Identify the common causes of accidents and conditions under which they are most likely to occur.

- ✓ Build safety into the system right from the design of the building.
- ✓ Provide safety equipment, protective devices and clothing.
- ✓ Conduct regular risk assessments, audits, inspections, and checks and take corrective action to eliminate risks.
- ✓ Investigate all accidents and damage, establish the causes and take corrective action.
- ✓ Maintain good records and statistics in order to identify problem areas and unsatisfactory trends.
- ✓ Conduct a continuous program of education and training on safe working habits and methods for avoiding accidents.

The legal provisions for Health and Safety

The factories Act Cap. 198, Article 4 provides for health and safety and welfare of employees in factories and other places. This is the most important legislation regarding employees' health and safety and welfare at work in Uganda. Also read the employment Act.

Every employee has the right to work under a healthy and safe environment.

Factories Act Cap 198 ensures that employees are not exposed to risks and injury.

It is the duty of every employer to provide a safe system of work for his or her employees.

The Workman's Compensation Act 8/2000 provides for compensation for injuries sustained at work in the course of duty. In case of permanent incapacitation or death as a result of injuries sustained at work, the employer is required to pay compensation equivalent to a monthly salary for 5 years i.e. $5 \times 12 \text{ months} = 60 \text{ months earnings}$.

Sexual Harassment at the work place

Sexual harassment at the work place is an unwelcome sexual advance from a colleague.

Challenges associated with sexual harassment

- It is difficult to prove sexual harassment, because in most cases there are no witnesses. In most cases the harasser is a man who can defend himself by denying e.g. may say that the sexual harassment is only an imagination of the victim or may say that he was provoked by the behavior of the female colleague.
- When handling a case of sexual harassment, the judge (management) must be fair not to favor the male over female or vice versa, boss over subordinate.
- Victims of sexual harassment are often not willing to take action for fear of being viewed negatively by other colleagues in the organization.
- Sexual harassment may be deep-rooted in the culture of the organization. For instance if the CEO is the type who abuses all the young ladies / gentlemen such as interns and new employees sexually, he or she is likely to set a wrong precedence that others in the organization may follow.

Dealing with sexual harassment

- The CEO should issue a clear statement that sexual harassment will not be tolerated in the organization.
- The organizational policy should spell out that sexual harassment is unacceptable, what the victims of sexual harassment can do to get help and the punishment for the harassers or offenders.
- Reinforce policy by demonstrating top management support and good will.
- Sexual harassment policy should be included in the induction package for new employees.
- Provide a conducive environment for the victims of sexual harassment to report and seek advice, provide support and counseling services.
- Establish special procedures for hearing complaints of sexual harassment since normal procedures may not be applicable because the harasser may be the victim's manager or supervisor. If possible victims should submit complaints to someone of the same sex.

- Managers should handle sexual harassment complaints with sensitivity and respect for the rights, privacy and dignity of the complainant and the accused.
- Hearing should be conducted fairly and both parties should be given an equal opportunity to state their case.
- Sexual harassment should be highlighted as a gross misconduct which tantamounts to summary dismissal if found guilty.
- Every employee joining the organization should know right from the onset that the organization takes severe action against anyone found guilty of sexual harassment.
- Line managers and or supervisors or team leaders should be trained to ensure that the policy is properly implemented and make them aware of their direct responsibility to prevent harassment in their departments or divisions.

Although it may be difficult to eradicate sexual harassment, every manager is duty bound to do all that is his or her powers to minimize such incidents in an organization.

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PRODUCTION IN ECONOMICS

Factors of Production

Production is the creation of utility. Production of any commodity involves combining several factors of production. When combined the various factors of production produce goods and services that provide utility to the consumers. Costs of production are grouped into two broad categories i.e. variable and fixed costs. There are four major factors of production:

- ✚ Natural resources e.g. land, trees or forests, oil resources, rivers, lakes, minerals etc
- ✚ Labor is human effort that is applied to natural resources in producing goods and services.
- ✚ Capital refers to the tools that are used by labor in making products. Money is not capital but it can be considered capital when it is used to buy factories, equipments or anything else in the production process.
- ✚ Entrepreneurship is the ability to bring about production including the owner or manager of a firm who organizes other factors of production and takes the risks associated with running a business.

ECONOMICS

There are 2 branches of economics i.e. microeconomics and macroeconomics. Microeconomics studies economic behaviour of individual economic entities and variables e.g. households, firms, prices, wages, commodities etc. Microeconomics deals with choices and decision-making behaviour of the individual households, firms, industries, relationships between prices and quantities of individual goods and services.

MACROECONOMICS

Macroeconomics is concerned with behaviour and relationships between the national aggregates such as national income or output, total consumption, saving and investment, total

employment, total money supply, general price level, aggregate expenditure and supply of goods and services. Macroeconomics does not deal with individual quantities.

Importance of Macroeconomics

1. Helps in generalizing the behaviour and character of individual components of the economy.
2. Provides a basis for public policy formulation. The main objective of the government activities and programmes is to control and regulate the economic system of the country so as to achieve the desired goals and fulfil the aspirations of society.
3. Macroeconomic models can be used to predict the future level of output, employment, consumption, prices etc on the basis of certain established assumptions to facilitate planning.

Limitations of the Macroeconomic Theory

1. Its applicability is limited only to aggregates i.e. what's true of aggregates may not be true of the individual components of the aggregates. For example, even if aggregate national output is increasing, the output in some sectors, regions, individual industries etc may be decreasing.
2. It ignores structural changes in constituent elements of the aggregate. For example, growth in national income might lead to the conclusion that the country is performing well but such growth may be accompanied by structural changes such as excessive substitution of capital for labour and transfer of income from the poor to the rich, rise in unemployment etc. hence the growth in national income in this case will not be considered a health sign for the economy.
3. Macroeconomics deals with the aggregates and aggregates are not reality but a picture or approximation of reality. The aggregates are heterogeneous and not homogeneous though converting into money value has solved this problem
4. Macroeconomics has limited practical application.

MACROECONOMIC CONCEPTS

NATIONAL INCOME / GROSS NATIONAL PRODUCT (GNP)

Economics deals with the material well being of people. People derive this material well being from the flow of goods and services available for their use and produced by a country with in a given period, normally a year. It is this flow, which is called national income. Our nation's

income is determined by the amount we produce. Since early 1990s the GDP became the most frequently used measure of the value of production.

National income is a measure of the money value of goods and services, which arise from the productive activities of the nation in any one given year. Gross Domestic Product (GDP) refers to the value of all services and products produced within the boundaries of a given country, whether by its nationals or foreign companies. Whereas Gross National Product (GNP) is the value of all goods and services Produced by nationals of a given country e.g. by all Ugandans whether in Uganda or in the diaspora e.g. by 'Kyeyos'.

The net national income is normally obtained after subtracting the costs of depreciation from the national income. In LDCs like Uganda, we prefer to use the Gross National Product (GNP) or Gross Domestic Product (GDP) rather than the net national income. This is because costs of depreciation are very uncertain.

GROSS DOMESTIC PRODUCT (GDP)

GDP is defined as the retail market value of everything produced in a country in a year regardless of who produces or owns the firms that produced the goods or services. Before 1990 the standard measure of production was GNP (gross national product). GNP included interests and dividends or profits of foreign firms received by residents of this country. GDP excludes these payments. Economists consider GDP to be a better measure of production than GNP. There are two basic methods used to calculate GDP i.e. expenditure and income approaches:

- i. Expenditure Method. Purchasers' expenditure. Obtained by adding up market expenditure by final consumers, including purchase of capital goods by firms.
- ii. Income Method. Sum of income received by the various producers. Obtained by adding up the incomes received by the different individuals who contributed to output.

The Expenditure Approach

Computes the value of GDP by adding together all the spending for new goods and services produced in a year. It is based on the fact that someone must pay for all new production. Hence it is possible to measure production by measuring spending

Under this approach – spending is organized into 4 categories;

- ✓ Consumer or consumption spending
- ✓ Government spending (20%)
- ✓ Business spending (20%)
- ✓ Net spending by foreign purchases (-10%)

The spending in all these four categories is totalled to obtain the GDP. Net foreign spending is the difference between what a country (Uganda) exports and imports.

The Income Approach

GDP is calculated by adding up all the income earned in producing the GDP. It is based on the premise that if income depends on the value of production then it is possible to measure the value of production by measuring income. These income values can be obtained from URA. These values include wages, profits, rent, interest and some taxes and cost of depreciation. One problem arising here is that it cannot capture the activities in the underground economy.

Problems in Computing GDP

- ✓ May include production which does not exist
- ✓ Double counting – e.g. if a firm buys a wheel at 50,000 Uganda shillings, polishes the wheel and sells it at 80,000 shillings, this firm has only added 30,000/= worth of value. Government / URA must be careful not to count this firm's contribution as 80,000/=. Doing so would mean double counting because 50,000/= worth of value was already counted as part of GDP under the first firm.
- ✓ Spending on products produced in some other year e.g. roofing tiles should not be included as part of GDP for this year.
- ✓ Some components of production are not included in GDP. Only paid work is counted e.g. if you treat animals on your farm, no value is added to GDP but if you treat animals at your neighbour's farm and you are paid 100,000/= and you report it to government it will be counted as part of GDP.
- ✓ Home makers create value everyday but it is not considered into GDP since they are not paid a wage.
- ✓ The underground economy is the greatest problem hindering accurate measurement of GDP. Many people work, produce value and are paid but do not report their income to government.

- ✓ Underground production causes reported GDP to be smaller than the actual production really is.
- ✓ Some production goes unreported because it is illegal e.g. selling narcotic drugs, gambling, prostitution etc. some production is not included into GDP but it is part of our economic system.
- ✓ The relationship between GDP and our quality of life is not clear
- ✓ Often times GDP is reported in nominal values –meaning that it is not adjusted for inflation. GDP growth can be a result of higher prices and not increased production. GDP can be adjusted for inflation to get the real value growth in GDP.

The real value growth in GDP can further be adjusted for population growth.

Why measure GDP?

Measuring GDP has practical value to Uganda and Ugandans. By measuring changes in the growth of GDP annually economists are able to track the health of the economy. If GDP fails to grow significantly it is a sign that there may be underlying problems in the economy.

If GDP grows substantially, it means that the country's economic policies are favourable and do not need fixing.

GDP & Quality of Life

Income is not evenly distributed. New production may benefit only the high income earners. People don't share equally in benefits of increased productivity.

STANDARD OF LIVING (SOL) / ECONOMIC WELFARE

Refers to the socio-economic material welfare of an individual or society as it is represented by the basket of goods and services consumed. It describes the conditions under which people live or aspire to live.

The indicators of the SOL in an economy include: Cost of living, Level of income and its distribution, Literacy rate / level of education, Level of technology used, Employment level, Availability of health facilities, Degree of freedom and security, Life expectancy, Level of energy consumption, Nutrition levels, and Housing and accommodation levels.

Why is per capita income not a good indicator of SOL?

It does not take into account the distribution of national income. Per capita income may be high but when income and resources are concentrated into hands of a few individuals while the majority is poor and cannot access a variety of goods and services.

Per capita income does not take into account the nature and pattern of expenditure in an economy. It might be high due to high expenditure on non-productive goods that do not improve people's SOL e.g. on capital goods that do not improve people's welfare directly.

It does not consider amount of leisure enjoyed. Per capita income may be high when people are working long hours and foregoing leisure hence poor SOL.

It does not consider the working conditions in an economy hence may be high but when workers are faced with high occupational hazards which greatly lower their SOL.

It does not consider the level of subsistence sector. Per capita income may be low in a country with a big subsistence sector where there is omission of non-marketed output yet this directly improves on individual welfare etc.

INFLATION

Inflation refers to the continual increase in prices. The value or purchasing power of money refers to the amount of goods or services one shilling can buy. Inflation means the value of money is falling because prices keep rising.

Inflation measures the annual rate of change of the general price level in the economy. Inflation is a sustained increase in the average price level. We focus here on the overall level of prices throughout the economy rather than prices in one particular market or industry. It is quite possible for prices to be falling, for example in audio-visual equipment or textiles, but for there to be general price inflation across a wide range of goods and services.

When hyperinflation occurs, the value of money becomes worthless and people lose all confidence in money both as a store of value and also as a medium of exchange. Often drastic action is required to stabilize an economy suffering from high and volatile inflation - and this leads to political and social instability.

Measurement of Inflation

RPI - retail price index.

Calculating the Retail Price Index. The retail or Consumer price index (RPI) is a monthly survey carried out by the government which measures price changes. The following procedure is used:

A basket of goods and services consumed by the average family is listed. For example, food, clothing and transport are included in the basket. The price of items in the basket in the base (first) year is noted.

Each item in the basket is given a number value (weighted) to reflect its importance to the average family. For example, food has a higher weighting than transport.

The price of goods in the basket is recorded every month compared with base year as a percentage (price relative) using the equation: $\text{Price relative} = \text{Current price} / \text{Base price} \times 100$.

The price relative of each item is then multiplied by its weighting.

The new RPI is obtained using the equation:

$$\text{RPI} = \frac{\text{Total weightings} \times \text{Price relative}}{\text{Total weightings}}$$

The value of the RPI in the base year is always 100. After twelve months the price of food items in the basket may have risen by 25 per cent and that of housing by 20 per cent while the cost of transport is unchanged. The table below shows how the RPI for year two might then be calculated. The $\text{RPI} = \text{Total weightings} \times \text{Price relative} / \text{Total weightings}$.

Calculation of the Retail Price Index

Basket	Weighting	Price relative	Weightings * Price Relative
Food	60	125	7500
Housing	30	120	3600
Transport	10	100	1000
Total	100		12100

The rate of inflation is the percentage change in the RPI over the last twelve months and is calculated using the equation:

$$\text{Rate of inflation} = (\text{Current RPI} - \text{Last RPI}) / \text{Last RPI} \times 100$$

At the beginning of year two the rate of inflation is: $(121 - 100) / 100 \times 100 = 21$ per cent

Problems in Using the Retail Price Index

1. Which items should be included in or excluded from the basket of goods?
2. Different families have different tastes hence different weightings. How is an average family found?
3. Not all regions in the country experience identical price changes.
4. New products (e.g. mobile phones) may not be included in the index.

Advantages of Inflation

Not everyone suffers from inflation. Some parts of society actually benefit:

1. The government finds that people earn more and so pay more income tax.
2. Firms are able to increase prices and profits before they pay out higher wages.

3. Debtors (borrowers) gain because they have use of money now, when its purchasing power is greater.

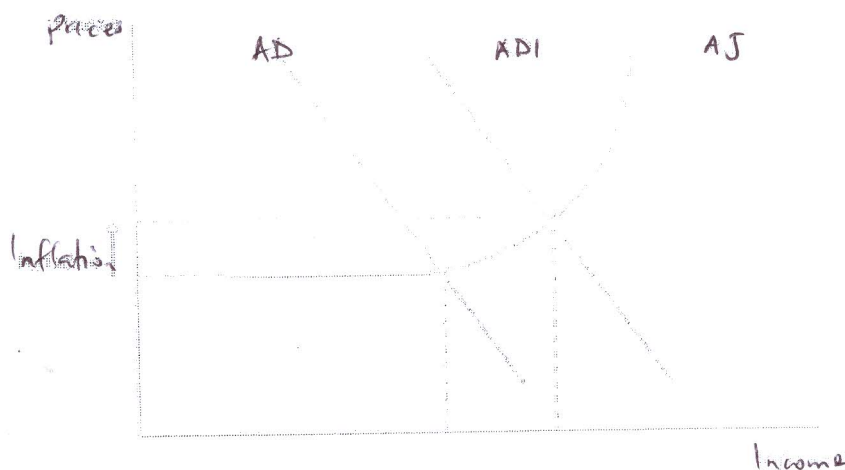
Disadvantages of Inflation

1. People on fixed incomes are unable to buy so many goods.
2. Creditors (savers) lose because the loan will have reduced purchasing power when it is repaid.
3. Ugandan goods may become more expensive than foreign-made products so the balance of payments suffers.
4. Industrial disputes may occur if workers are unable to secure wage increases to restore their standard of living.

Causes of Inflation

Cost-push Inflation occurs when a firm passes on an increase in production costs to the consumer. The inflationary effect of increased costs can be the result of:

- i. Increased wages, leading to; a *wage-price spiral*, which occurs when price increases spark off a series of wage demands which lead to further price increases and so on; and a *wage-wage spiral*, which occurs when one group of workers receive a wage increase which sparks off a series of wage demands from other workers.
- ii. Increased import prices, which can be the result of: a rise in world prices for imported raw materials; and a depreciation of shilling
- iii. *Demand-pull inflation* occurs when there is too much money chasing too few goods because the demand for current output exceeds supply.
- iv. The figure below shows increased demand and increased prices as consumers compete to buy up goods still available.



A major source of inflationary pressure is the government, which can print money to buy goods. The *monetarist* view of inflation can be stated in the equation:

$MV = PT$ Where M = the money supply,

V = the number of times each shilling changes hands (the *velocity of circulation*),

P - The average price of goods, and T = the number of goods bought (*transactions*).

Monetarists believe that the values of V and T are fixed so that any increase in M, the money supply, must raise P, the level of prices, i.e. be inflationary.

Economic Policies to Control Inflation

The control of inflation has become one of the dominant objectives of government economic policy in many countries. Effective policies to control inflation need to focus on the underlying causes of inflation in the economy. For example if the main cause is excess demand for goods and services, then government policy should look to reduce the level of aggregate demand. If cost-push inflation is the root cause, production costs need to be controlled for the problem to be reduced.

Cost-push Remedies

1. Introduce a prices and incomes policy to free price and wage increases.
2. Encourage an appreciation of the shilling.

Reduce indirect taxation.

The economy is continuously experiencing changes in relative prices as demand-supply conditions alter in individual markets. For example the relative price of hi-tech goods including PCs and Multi-Media equipment is falling whilst the relative price of airtime and fuels has increased in recent years not least because of rising levels of indirect taxes applied on these goods by the government in successive budget announcements.

Demand-pull Remedies

1. Reduce government spending.
2. Increase income tax to reduce consumer spending.
3. Reduce people's ability to borrow money by increasing interest rates and tightening credit regulations.
4. Control the supply of money.

Monetary Policy -can control the growth of demand through an increase in interest rates and a contraction in the real money supply. Higher interest rates reduce aggregate demand in the following ways;

1. Discouraging borrowing by both households and companies

2. Increasing the rate of saving (the opportunity cost of spending has increased)
3. The rise in mortgage interest payments will reduce homeowners' real 'effective' disposable income and their ability to spend. Increased mortgage costs will also reduce market demand in the housing market
4. Business investment may also fall, as the cost of borrowing funds will increase. Some planned investment projects will now become unprofitable and, as a result, aggregate demand will fall.
5. Higher interest rates could also be used to limit monetary inflation. A rise in real interest rates should reduce the demand for lending and therefore reduce the growth of broad money.

Direct Wage Controls - Income Policies - set limits on the rate of growth of wages and have the potential to reduce cost inflation.

Wage inflation normally falls when the economy is heading into recession and unemployment starts to rise. This causes greater job insecurity and some workers may trade off lower pay claims for some degree of employment protection.

Long-Term Policies to Control Inflation

Labor market reforms. The weakening of trade union power, the growth of part-time and temporary working along with the expansion of flexible working hours are all moves that have increased flexibility in the labor market. If this does allow firms to control their labor costs it may reduce costs and push inflationary pressure.

Supply-side reforms. If a greater output can be produced at a lower cost per unit, then the economy can achieve sustained economic growth without inflation. An increase in aggregate supply is often a key long-term objective of Government economic policy.

Supply side reforms seek to increase the productive capacity of the economy in the long-run and raise the trend rate of growth of labor and capital productivity. Productivity gains help to control unit labor costs (an important cause of cost-push inflation) and put less pressure on producers to raise their prices.

The key to controlling inflation in the long run is for the authorities to keep control of aggregate demand (through fiscal and monetary policy) and at the same time seek to achieve improvements to the supply side of the economy.

Problems with forecasting inflation

Inflation can never be forecast with perfect accuracy. The overall inflation measure is the result of millions of pricing decisions made by businesses large and small. The calculation of the retail price index although extremely thorough, is always subject to error and omission. Furthermore, the nature of the inflation process makes it very difficult to forecast, even when inflationary conditions in the economy appear to be benign.

External economic shocks can make forecasts inaccurate. For example, a sharp jump in world oil prices (an inflationary shock) or deep falls in global share prices (a deflationary shock), both have big feedback effects through the economic system. The exchange rate might also fluctuate leading to volatility in the prices of imported goods and services.

Inflation And Economic Growth - Is There A Trade-Off?

Sustained growth caused by rising aggregate demand can lead to acceleration in inflation as the economy uses up scarce resources and short-run aggregate supply becomes inelastic. The tradeoff between growth and inflation can be avoided if an economy is able to increase potential output by improving their supply-side performance.

Deflation refers to a **decrease** in the **general price level** of the economy. A fall in prices in particular markets, such as housing, share prices or the market for electronic goods or textiles is not the same as **economy-wide deflation**.

Most economists believe that **disinflation** or falling inflation is beneficial for the economy. A stable price level can lead to better decisions and a more efficient use of scarce resources. Lower inflation also helps to stabilize inflationary expectations. A decline in prices after an improvement in **productivity** allows companies to cut costs and prices, thereby raising **living standards**.

The undesirable type of deflation is the kind that is broadly based throughout the economy, long lasting, and symptomatic of a weak economy stuck in recession. When prices are falling, consumers may decide to postpone purchases in the expectation of buying the item at a cheaper price later on. This causes a fall in demand and can create further price declines.

Cutting interest rates may not be sufficient during a credit crunch. In this case, **expansionary fiscal policy** (lower direct and indirect taxes and higher government spending) is often prescribed to cure deflation.

One reason deflation is difficult to cure is that **nominal interest rates** cannot fall below zero, while prices of goods and services can fall for a long time. In this event, monetary policy is unable to prevent higher real interest rates and the economy spirals downwards towards a slump caused by falling prices, contracting output, falling investment, plant closures and increasing levels of job losses in those industries affected.

EMPLOYMENT / UNEMPLOYMENT

Full employment, or the *natural rate* of unemployment, is considered to be consistent with a level of unemployment that predominantly comprises involuntarily unemployed workers i.e. those members of the labor force who really want a job but don't have one.

Unemployment consistent with full employment is a major issue for economic policymakers. Small differences in the perceived rate of full employment lead to significant variations in the policy response to economic growth.

Rising wages increase costs, which are usually passed on to consumers as price increases, leading to rising inflation.

To understand the relationship between full employment and wage increases, let us assume that the agreed upon natural unemployment rate is 5%. If the unemployment rate is 8%, then there are workers who desire jobs but cannot obtain one (known as involuntary unemployment).

High unemployment rates, the existing labor surplus implies that employers have little trouble finding people to work at the prevailing wage rate. But as economic growth accelerates, the labor surplus diminishes as more workers are hired, and the unemployment rate falls. Finally, due to strong economic growth, the unemployment rate falls to a level consistent with full employment.

Increases in the demand for labor continues to grow and employers must pay existing workers overtime and entice non-labor force participants into the labor force by offering them higher wages. As wages increase, more people are willing to work, but production costs rise. If strong economic growth persists, wages pressures continue to build, leading to increasing inflation (also known as cost-push inflation). A loss of worker negotiating power (unions, etc.) weakens the ability of employees to negotiate wage raises.

The re-engineering of the workplace has led to large-scale layoffs during periods of economic growth and in companies earning record profits. Insecure workers have little ability to ask for raises. The global economy makes it easier to shift jobs into overseas production when domestic wage pressure builds. Foreign production provides a relief valve to domestic wage pressures.

Even as renewed economic vigor allows many unemployed people to return to work, unemployment rates do not fall to zero. Some individuals choose to be unemployed during a brief transition, usually lasting less than five weeks. Perhaps they are taking some time off in-between jobs or moving to another part of the country.

In contrast to those who are voluntarily unemployed, there are those who remain unemployed regardless if the economy is booming or sinking. The long-term unemployed are considered to be structurally unemployed. Members of this group may lack the education and skills to find work or they may simply be in the wrong place.

When full employment is reached, the remaining unemployed are considered to be structurally unemployed. The individuals concerned lack the skills and education that are in demand.

MONEY

Money is a medium of exchange. Money also acts a standard of value, is a unit of account of the present and future payments. Money provides a common basis for calculating rates of exchange between all goods and services.

Functions of Payment

The most important function of money is to act as a medium of exchange. It must be generally acceptable as payment. As a standard of value it is used in contracts as standard of deferred payments.

Money is a store of value or wealth; it can be accumulated for future spending. Money is convenient for this purpose because it is liquid i.e. can be readily transferred into other forms

of wealth, it involves no costs of storage and it carries little risk of physical deterioration though may change in real value in terms of purchasing power.

Characteristics of money

1. It must be generally acceptable
2. Easily transportable so as to act as a medium of exchange
3. It must be divisible so as to act as a unit of account
4. To act as a store of value it must be durable

Development of money emerged out of barter trade that involved physical exchange of commodities. To date cattle are still used to settle debts because they have an advantage in transportability and convertibility into cash over crops.

TERMS OF TRADE (TOT)

Expresses the relationship between exports and imports. It defines the terms upon which a country exchanges exports for imports. The TOT improve or become favourable when exports command a great volume of imports.

Many LDCs face unfavourable TOT in international trade because of the poor conditions e.g. tariffs, non-tariff barriers to trade such as over restriction on certain commodities, over production and exportation of primary goods that fetch little on the foreign market, poor quality products, high competition from developed country producers with subsidies etc

BALANCE OF PAYMENT (BOP)

It is a summary record of all economic transactions among residences of different countries during a given period of time usually one year. It shows a country's total expenditure versus total income from foreign exchange.

It includes transactions involving the physical movement of services and goods, movement of capital goods into and outside the country.

The relationship between the payment for imports of visible trade and receipts from tangible exports is referred to as balance of payment.

NATIONAL DEBT

It is the total financial obligations of a national government. It is the amount of borrowing by the government to meet expenditures exceeding tax revenues. A large national debt can inhibit growth and drive up interest rates.

Reliance on debt financing during wars can be justified in economic theory by treating war expenditures as investments (in national survival or territorial expansion, for example) benefiting later generations who ought to help pay for the benefits by servicing the debt. A more likely explanation is one of expedience: wars call for rapid increases in expenditures, but equally rapid increases in compulsory taxation would be less popular than borrowing.

The total level of gross government debt is expected to fall consistently year by year and the ratio of government debt to GDP to drop if the economy continues to enjoy sustained growth. The National Debt is the accumulated debt built up by the government over a number of years that has not yet been repaid. **Government debt / public debt or national debt** is money owed by any level of government; either central government, federal government, municipal government or local government.

Why should we be concerned about the national debt?

Governments represent people and government debt can be seen as an indirect debt upon the tax payers.

Global debt is of great concern since, very often, social capital is depleted and natural capital is ravaged as natural resources are used to pay back the debt and interest. This has led to calls for universal debt relief for poorer countries. Civil societies are advocating for accountable governments as a means to minimize national debt and the consequential burden on the tax payer.

Using a debt to GDP ratio is one of the most accepted measures of assessing a nation's debt. In contrast, per capita measures are often inappropriate, particularly in developing countries which have far more people than capital.

Economists generally believe the best level for our National Debt (ND) is zero - that is, no debt at all. They also believe we must balance the budget each and every year. If our National Debt is "considerable", we must "tighten our belts", sacrifice, increase taxes, and do whatever is

necessary so we can show a surplus, and get that National Debt down to zero even if it means a higher unemployment rate and nipping a boom in the bud!

National Debt many times doubles the Gross National Product, especially when interest rates are high, which places a devastating burden on a country, particularly if the debt were incurred inefficiently e.g. a war. Very large deficits and long-term debts can be justified if the programs for which this money will be used can be shown to improve some aspect of the society so the outlay can be considered an investment that will pay for itself over and above expected interest rates.

Since such programs always exist, it can be stated that some level of ND is better than no ND at all and that a National Surplus would thus be counterproductive and not in the present or future best interests of the country.

Prudent borrowing for valid purposes allows individuals, corporations, cities, or nations, to progress faster or to accomplish tasks that would not have otherwise been possible. Another way of looking at the ND/GNP ratio is to ask how many man-hours of labor it would take for each working person to pay off his share of the National Debt.

TAXATION

Taxation is a means of transferring money from individuals into public coffers / pool.

Taxation is the method by which a government gains revenue to spend on things like public services or goods and welfare benefits. There are many methods by which tax revenue can be gained, and different definitions and structures to taxation which are outlined below. Also, conflicts in choosing methods and forms of taxation occur, putting priorities such as reducing inequity of income against maximizing incentive for economic growth.

Principles of a good tax system. The following were first proposed by the great economist Adam Smith and are still applicable to date:

1. Efficient – a tax system should raise enough revenue such that government projects can be adequately sponsored, without burdening the tax payer too much, or disincentivising investment or work.
2. Understandable – the system should not be too complex to the lay person nor should it appear unjust or unmindfully complex. This is to minimize discontent, and costs.

3. Equitable. Taxation should be governed by people's ability to pay i.e. wealthier individuals or firms with greater incomes should pay more in tax while those with lower incomes should pay comparatively less.
4. Benefit Principle. Consumers of public services, funded primarily through taxation should pay for it by honoring their tax obligations. However, this principle seems to conflict with the principle of equity. Tax must be proportional i.e. computed as a percentage of one's tax, the low income earner will be taxed at 20% and so is the high income earner. The proportion of tax paid is always the same, though in absolute terms it goes up the higher one's income.
5. Progressive taxation means that higher income earners pay a greater proportion of their income in tax than low earners.
6. Regressive taxation is rarely done by governments because it would be unpopular and would seem to support the wealthy, high income individuals over more needy households. However, indirect taxation could be said to partly support this. Very high income earners may spend a lower proportion of their income on goods and services, and so pay proportionally a fewer taxes as a percentage of their income.

Direct and Indirect Taxation

Direct taxes are paid by taxation on the income of the wage earner. This form of taxation is unavoidable and for simplicity, it usually collected before the worker collects his/her salary e.g. PAYE.

Indirect taxation is often avoidable and is not taken from salaries. An example is VAT (Value Added Tax) or sales tax placed on goods and services. Not all people have to pay these taxes, they may choose not to.

There are several benefits and costs of both direct and indirect taxation. Direct taxation reduces the incentive to work as 'take home' pay is reduced as a result of an increase in income tax. While indirect taxation may result in people with similar incomes and wealth paying different amounts, as a result of slightly different circumstances. For instance, someone who has to travel 50km to work every day will pay more tax over the year than another who lives within a walkable distance to work, although they may earn the same amount and use the same public services. This is explained by a high tax on fuel (petrol / diesel).