

Sourcebook on economic literacy for trade unions in Africa

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**International Labour Organization
Norwegian Confederation of Trade Unions**

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Sourcebook on economic literacy for trade unions in Africa

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About Norwegian Confederation of Trade Unions



The Norwegian Confederation of Trade Unions (LO-Norway) is Norway's largest and most influential workers' organization. About 850,000 workers are affiliated to the national unions, which in turn are affiliated to LO. Fifty per cent of LO's members are women. In some unions, women make up three quarters of the membership.

About Bureau for Workers' Activities



The Bureau for Workers' Activities (ACTRAV) is the main link between the International Labour Office and workers. ACTRAV coordinates all the activities related to workers and their organizations, both at headquarters and in the field. The International Labour Organization (ILO), whose executive secretariat is the International Labour Office, is the only tripartite agency of the United Nations. In it, governments, as well as employers and workers, are represented on an equal footing. They benefit equally from the services of the Organization.

ACTRAV's mission is to maintain close relations with the trade union movement throughout the world, and to provide trade unions with the support of the International Labour Office in endeavours to strengthen their influence by promoting activities that defend and advance the rights of workers.

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Preface

Most people find economics boring or intimidating. They tend to think that it is an area that is best left to the 'experts'. The truth is that we are all part of the economy—workers, unemployed people, consumers, rich and poor. We all live the economy; we enjoy its benefits and suffer its failures and, therefore, we should have some say about how it works—what are the rules, who decides, who benefits. Economic literacy means having a basic understanding of how the economy works.

This sourcebook was derived from the understanding that trade union members and their leaders need to keep abreast with new trends in social and economic development. A more and better informed trade union movement is desirable not only to enable the full engagement of employers, governments and international organizations on key issues affecting workers and their communities, but also to ensure that their views are heard and listened to.

The compelling rationale to initiate the project that resulted into this sourcebook was the realization that despite the dramatic changes in the world of work in the last three decades or so, trade unions have had to contend with workers education materials that were mostly developed in the 1980s. We observed that although most of these earlier materials have stood the test of time, an earlier era resonates in some of the content and tone. The onset of new challenges calls for the re-examination of trade union education materials to take into account global changes and to reflect, in more modern, gender-neutral language, developments and concepts that either did not exist or were of lesser importance a generation ago.

The emergence of a new and younger trade union generation provides a further stimulus to this effort. The absence of appropriate educational materials in economic literacy has made it difficult for union leaders to respond adequately to these changes in the quest to serve their membership better. It is, therefore, important to design a new workers education tool that will enable trade unions in Africa move in tandem with changes around them and, in particular, those attributed to such issues as globalization, poverty alleviation, informal economy, HIV and AIDS and new economic policies.

No doubt, the new emerging issues have entailed a rethinking of the approach to collective bargaining, requiring new techniques of bargaining, with emphasis on the role of unions at the enterprise level. Many trade union educators and leaders believe that it may not be possible to utilize the existing tools and materials in their entirety to fit the calibre of activists working at the enterprise level. This requires the development of new trade union material that can easily be comprehended by shop-stewards and branch officials for collective bargaining and effective negotiations in order to advance and defend workers aspirations and rights. This is the void intended to be filled by this sourcebook on economic literacy.

The sourcebook is based on economic issues affecting the African economic environment beyond number crunching and data analysis. The aim is to help unions use the information to change the daily lives of their members and cope with the dynamic adjustment of the workplace.

It is our hope that the sourcebook will empower trade union leaders with information meant to point towards the connection between the economy and the workplaces and make decisions for approaching change in the world of work.

Dan Cunniah,
Director, ILO/ACTRAV

Roar Flåthen
President, LO-Norway

Acknowledgements

“Economics doesn’t just happen in classrooms or banks. It is everywhere and influences everything we do and see, from the cinema screen to the streets. It can even explain some of the life’s most intriguing enigmas.”

*Robert H. Frank (2008),
The Economic Naturalist:
Why Economics Explains Almost Everything.
London: Virgin Books Ltd*

Economic literacy as presented in this sourcebook is not merely about understanding microeconomics and macroeconomics. The intention is also about presenting probing and critical thinking about the core ideas in economic theory and political agendas behind government policy and at various forums: at the national, regional and international levels. The principle inspiration is that economic literacy must also equip trade unions and other activists to trace the logical connection between their local economic situation and realities of national and global economic policy dynamics in order to enable them to strategize on how to participate in and pressure for desirable and sustainable change.

Although this sourcebook was developed through a special project initiative facilitated by the Norwegian Confederation of Trade Unions (LO-Norway) in collaboration with the ILO Bureau for Workers’ Activities (ACTRAV) it is indeed a product of a shared vision and ownership by the trade union movement in Africa. It has seen the light of day courtesy to the guidance and encouragement of trade union leadership and experts from leading national centres in Africa.

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Alice Gondwe-Siame, Consultant, LO-Norway (Ndola)
Mohammed Mwamadzingo, Senior Economist, ILO/ACTRAV (Geneva)

September 2008

Abbreviations and acronyms

AAF-SAF	African Alternative Framework to SAPs
ACP	African, Caribbean and Pacific countries
AGOA	US Government's African Growth and Opportunity Act
AIDS	Acquired Immune Deficiency Syndrome
AU	African Union
CAR	Compact for African Recovery
CSO	Civil Society Organizations
CSR	Corporate Social Responsibility
EU	European Union
FDI	Foreign Direct Investment
G8	Group of Eight Industrialized Countries
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product (National Income)
GUF	Global Union Federation
HIV	Human Immunodeficiency Virus
ICFTU	International Confederation of Free Trade Unions
ICT	Information and Communications Technologies
IDDA	Industrial Development Decade for Africa
IFI	International Financial Institution
IMF	International Monetary Fund
ILO	International Labour Organization
ITUC	International Trade Union Confederation
MAP	Millennium Partnership for Africa's Development
MDGs	Millennium Development Goals
MDGRs	MDG Reports or Reviews
MNCs	Multi-National Corporations
NEPAD	New Partnership for Africa's Development
NGOs	Non-Governmental Organizations
OATUU	Organization of African Trade Union Unity
OAU	Organization of African Unity
PLWAs	People Living With AIDS
PRSPs	Poverty Reduction Strategy Papers
SAPs	Structural Adjustment Programmes
TICAD	Japan's Tokyo International Conference on African Development
UN	United Nations
UNAIDS	United Nations Joint Programme on HIV/AIDS
UNECA	United Nations Economic Commission for Africa
WCL	World Confederation of Labour
World Bank	International Bank for Reconstruction and Development
WTO	World Trade Organization

Description and structure of the sourcebook

“Every morning
in Africa, a
Gazelle wakes up.
It knows it must
run faster than
the fastest lion or
it will be killed.
Every morning
a Lion wakes
up. It knows it
must outrun the
slowest Gazelle
or it will starve to
death. It doesn’t
matter whether
you are a Lion or
a Gazelle... when
the sun comes up,
you’d better be
running.”

Anonymous

Description of the sourcebook

Many trade union activists are interested in an economic perspective and insight into the world in which we all live. This is because many socio-political questions are rooted in economics: Why should inflation exist? What drives economic growth? Why are unemployment figures high in one country and low in another? Why are footballers paid more than gold miners? Why is the price of tea, tobacco, coffee, and copper of interest to Kenyans, Malawians, Ugandans, and Zambians? The questions are endless. An individual with a grasp of essential economic principles becomes a more effective participant in the economy, to both personal and society’s advantage. A grasp of economics makes us more effective critics of government policy.

Curriculum “sourcebooks” are becoming a popular genre in trade union education. A sourcebook, unlike a structured curriculum, offers a model and ideas for teaching and learning around a particular subject that allows facilitators to select, adapt, and use what fits them best.

This sourcebook will enable trade unions to understand the essentials of economics and provide an understanding of the issues of the day. The book aims to furnish a basic level of understanding of economic theory that underlies economic activity, and provides a solid background of knowledge of economic policy, problems and institutions. It should enable readers to have an enlightened perception of events that are reported and commented upon by the world’s business media and how these international events impact on the national economy and the workplace. The sourcebook can also be used as a teaching resource for people and organizations interested in conducting training or even just strengthening their own basic understanding of economics. No background in economics is assumed. The sourcebook is intended to be user friendly. It has tried to use plain language and avoid jargon whenever possible. When use of technical terms is inevitable, they are always defined and explained. Such terms are used because they are part of the basic vocabulary that one requires to engage in economic debate.

The reading level of this sourcebook is mixed. It ranges from simplified to some advanced readings on economics, some simplified charts, as well as some non-text-based activities to bring to the fore the understanding of current social and economic policy issues.

Much of the material in the sourcebook reflects the context of the countries that were initially selected to participate in the special project (Kenya, Malawi, Mozambique, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe). In addition, enough generic information on economic literacy is included to appeal to the entire African continent.

The sourcebook is an attempt at demystifying economics and economic policy to trade union leaders and at all levels: national, local and enterprise levels. It is equivalent to an education initiative aimed at unpacking the

key features, core assumptions, real consequences and hidden priorities behind economic policy. It is equivalent to what was initially referred to as “popular economics” or “ABC of economics”. The fundamental purpose is to make this knowledge more accessible and relevant to unionists, and thus enable them to challenge political-economic choices that are undemocratic or unsustainable.

Finally, the goal of the sourcebook is not to convert everyone to the same point of view, but rather to share vital information that all trade unionists need to know about the economic world we are living in.

How this sourcebook is structured

The sourcebook comprises six units in three distinct parts. There are two elements to the book: the book seeks firstly to introduce the basic principles and concepts of economics and, secondly, relates these concepts to African economic issues. The book begins in Part I by explaining some key principles of microeconomics. Part II addresses a series of major issues in economics while Part III provides a review of the political economy of the African continent. The book puts emphasis on economic concepts and their application to Africa.

The sourcebook contains balanced activities for trade union learners and material for facilitators. Many primary source material in the final section are intended to clarify and deepen understanding of economic concepts for trade union facilitators, so that they feel more comfortable exploring economic themes with their participants. Activities include work histories, inquiry projects about workers’ communities, lessons on topical issues, musical chair activities for understanding the labour market, and other creative and concrete ways to teach about the economy and how it affects us in every day life. The sourcebook also makes use of “myth-busters” feature by presenting myth/reality summaries on diverse topics that affect workers’ welfare.

A word of caution is appropriate. Economics is a subject quite unlike other subjects. Economic theory has a logical structure; it tends to build on itself from stage to stage. This sourcebook is also built on this format in that the reader who only imperfectly understands or appreciates some concept of theory in one part or unit of the book will run into increasing difficulty when, in subsequent developments, the concept or theory is taken for granted and built upon.

It follows from all this that readers should use this book in quite a different way than they would use a book on many other subjects. A book on economics is to be worked at, and understood step by step, and not to be read like a novel. It is usually a good idea to read a section quickly in order to see the general run of the argument, and then re-read it carefully, making sure that the argument is understood.

As you work through the sourcebook, you will find the following features to help you.



Definition

Meaning of key concepts in economics



You must know this

These are some of the fundamental ideas on which economics is based



Sources of information for your further reading



Distinguish between

Here you need to be able to explain the difference between one term or concept and another



Facilitator's outlines

Explanations of important themes and ideas in economics



Questions and answers

Short practical exercises to test your understanding



Myths-busters

Summaries of diverse topics that affect workers welfare

PART I: Introduction to economics

Unit 1: Introduction to key concepts in economics

Topics

“...the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else.”

John Maynard Keynes (British Economist whose ideas, called Keynesian economics, had a major impact on modern economic and political theory as well as on many governments' fiscal policies (1883–1946)

1. Definition of economics
2. Why is economics important?
3. History of economic thought
4. Branches of economics: Microeconomics and macroeconomics
5. Ideological structure of economics
6. Economic systems
7. Concept of wants and needs
8. Concept of goods and services
9. Why all the tables and charts in economics?
10. Concept of interdependence

1.1 Definition of economics

The word *economics* comes from the Greek words *oikos* (house) and *nomos* (custom or law). Economics, therefore, refers to the management of rules of the household. The economy is the management of the household of the nation or, increasingly, the management of the global household.

A definition that captures much of modern economics is that of Lionel Robbins in a 1932 essay: “*the science which studies human behaviour as a relationship between ends and scarce means, which have alternative uses* (Robbins, 1945:16).” In simple terms, economics is the study of how people make choices to satisfy their wants.

There is no one universally accepted answer to the question “What is economics?” However, a more precise answer to this question could be as follows:



Economics is the study of how individuals and groups make decisions with limited resources as to best satisfy their wants, needs, and desires.

As you may have noticed from the discussion above, there are three key ideas on what economics is all about:

- study
- choices
- wants

- (i) The first idea is that economics is a study. Economics is a study because it follows a systematic pattern and logic in deriving its arguments. It is in this context that economics is seen as a science that determines how people try to make use of the limited resources to meet their wants.
- (ii) The second idea is that people have to make choices because available resources are insufficient to satisfy all wants and needs. There would be no economic problem if the world did not experience any scarcity and people did not have to make alternative uses of available resources. Economics is, therefore, the study of choices as they are affected by incentives and resources.
- (iii) The third idea emerges from the understanding that people try to make use of the limited resources in the world to satisfy their wants. People have many wants for goods, such as the want for food or a want for a house. Economics helps people to make choices about how to spend these scarce resources on the different goods that they want.

1.2 Why is economics important?



Daily Nation, 4 January 2006. <http://www.gadonet.com>

Studying economics is important because it provides you with the knowledge and insight necessary to understand the impact of developments in business, society and the world economy. It enables you to understand the decisions of households, firms and governments based on human behaviour, beliefs, structure, constraints and need.

Economics is concerned with how society sets about meeting people's demands for things they want to consume. It looks at the production, consumption and sale of goods and services, both at the level of individual products, firms and consumers and at the level of the total production and consumption by countries. It also compares alternative ways of using the limited resources that countries and individuals possess and considers how efficient and/or fair such alternatives are.

Some knowledge of economics is relevant because we all make economic decisions every day of our lives, and the subject can help to improve our decision making. Economics offers a way of thinking about the world that enables us to make the best of what we have.

Contrary to what many people may think, the study of economics is not just about money or the stock market. Economics does help you to understand various aspects of finance, but it is also about choice, scarcity, opportunity, and the impact of decision making on aspects of society.

We also need to know that economics relates to a whole range of other subjects. Most economics degrees, even single honours economics degrees, will involve you studying other subjects to some extent. Economics is a social science, therefore it is closely related to subjects such as sociology, politics and international relations. To have a good grasp of how economies function, it also helps to be able to see economic problems in their historical context and how economic ideas have developed over time. For this reason, economics is closely related to history. Other subjects that are closely related to economics include business studies, human geography and psychology.

To be able to analyze economic problems, you will use a number of techniques. Some of these are mathematical and/or statistical.



Distinguish between economics and an economy

Economics is the study of how individuals and groups make decisions with limited resources as to best satisfy their wants, needs, and desires.

An economy is the total wealth of a given country at a given time. This wealth includes a country's resources such as capital, labour (human resources), land, minerals, goods and services.

1.3 History of economic thought

The history of economic thought is concerned with different thinkers and theories in the field of economics from the ancient world to the present day. Although British philosopher, Adam Smith, is generally considered the father of economics, his ideas built upon a considerable body of work from predecessors in the 18th century. They in turn were grappling with

wisdom received from centuries before and attempting to apply it to a modern setting.¹

Economics was not considered a separate discipline until the 19th century. One of the earlier economists included the ancient Greek philosopher, Aristotle, who grappled with the “art” of wealth acquisition and the question of whether property is best left in private or public hands.

Classical economics is widely regarded as the first modern school of economic thought. Its major developers include Adam Smith, David Ricardo, Thomas Malthus and John Stuart Mill, who examined the ways the landed, capitalist and labouring classes produced and distributed national riches. Sometimes, the definition of classical economics is expanded to include William Petty, Johann Heinrich von Thünen, and Karl Marx.

Adam Smith’s book entitled *Wealth of Nations* in 1776 is usually considered to mark the beginning of classical economics. The school was active into the mid-19th century and was followed by neoclassical economics in Britain beginning around 1870. Classical economists reoriented economics away from an analysis of the ruler’s personal interests to a class-based interest.

Karl Heinrich Marx addressed a wide variety of issues, including alienation and exploitation of the worker, the capitalist mode of production, and historical materialism. He is most famous, however, for his analysis of history in terms of class struggles, as summed up in the opening line of the introduction to the Communist Manifesto: “The history of all hitherto existing society is the history of class struggles.” The influence of his ideas, already popular during his life, was greatly broadened by the victory of the Russian Bolsheviks in the October Revolution of 1917. Indeed, there are few parts of the world that were not significantly touched by Marxian ideas in the course of the 20th century.

Neo-classical economics emerged in the imperial era and sought to advance a positive, mathematical and scientifically grounded field above normative politics. Neoclassical economics refers to a general approach in economics focusing on the determination of prices, outputs, and income distributions in markets through supply and demand. Mainstream economics is largely neoclassical in its assumptions, at least at the microeconomic level.

There have been many critiques of neoclassical economics, often incorporated into newer versions of neoclassical theory as human awareness about economic criteria change. Neoclassical economics is often called the marginalist school.

Neoclassical economics is an economic theory that argues for markets to be free. This means governments should generally not make rules about types of businesses, businesses’ behaviour, who may make things, who may sell things, who may buy things, prices, and quantities or types of things sold and bought. The theory argues that allowing individual actors (people or businesses) freedom creates better economic outcomes.

¹ Obtained from Wikipedia, the free encyclopedia, accessed on 10 July 2008: <http://www.wikipedia.com>

After the wars of the early 20th century, John Maynard Keynes led a reaction against government abstention from economic affairs, advocating interventionist fiscal policy to stimulate economic demand, growth and prosperity. But with a world divided between the capitalist first world, the communist second world, and the poor of the third world, the post-war consensus broke down. Men like Milton Friedman and Friedrich von Hayek caught the imagination of western leaders by focusing their theory on what could be achieved through better monetary policy and deregulation.

However, the reaction of governments through the 1980s has been challenged, and development economists like Amartya Sen and information economists like Joseph Stiglitz are bringing new ideas to economic thought in the 21st century.

1.4 Branches of economics: Microeconomics and macroeconomics

“Microeconomics:

The study of who has the money and how I can get my hands on it.

Macroeconomics:

The study of which government agency has the gun, and how we can get our hands on it.”

Economic historian, writer and publisher

Source: <http://www.lewrockwell.com/north/north603.html>

*Gary North
(born 1942)*

The two main branches of economics are microeconomics and macroeconomics. Microeconomics looks at the behaviour of individuals, homes, businesses or even groups of these. Microeconomics looks at prices of goods and of services. It wants to help people decide how to divide society's resources. To do this, microeconomics wants to understand how decisions are made and how these small decisions affect bigger issues.

Microeconomics is the science of how people make decisions at the small scale. The opposite is macroeconomics. In microeconomics, we might watch how a person chooses what to buy at the store, or how many things a company will make.

Macroeconomics looks at the whole economy. It tries to explain the causes of numbers such as national income, employment rates, and inflation. A good macroeconomic theory is based on microeconomics, meaning one can explain macroeconomic events using microeconomics for individuals.

Macroeconomics also looks at exchange rates. For example, if a country has a high exchange rate, not many people will want to buy its expensive products. Therefore, the demand will be lower, and so will the prices.



Microeconomics versus macroeconomics

Macro means large, therefore macro-economy is the whole economy, and includes factors such as growth (of GDP or GNP), inflation, unemployment, interest rates, trade, national budgets, etc.

Micro means small, therefore micro-economy refers to pieces of the economy, i.e. businesses, the labour market, worker preferences, etc.

Sub-disciplines of economics

There are a number of smaller branches (sub-disciplines) that do not fit neatly into one of the two main branches of economics, including:

- **Agricultural economics:** the study of the economic forces that affect the agricultural sector and the agricultural sector's impact on the rest of the economy.
- **Attention economics:** an approach to the management of information that treats human attention as a scarce commodity, and applies economic theory to solve various information management problems.
- **Behavioural economics:** applies scientific research on human and social cognitive and emotional biases to better understand economic decisions and how they affect market prices, returns and the allocation of resources.
- **Bioeconomics:** studies the dynamics of living resources in using economic models.
- **Contract theory:** studies how economic actors construct contractual arrangements, generally in the presence of asymmetric information. Contract theory is closely connected to the field of law and economics.
- **Development and growth economics:** growth economics studies factors that explain economic growth—the increase in output per capita of a country over a long period of time. Development economics examines economic aspects of the development process in relatively low income countries focussing on structural change, poverty, and economic growth.
- **Ecological economics:** addresses the metric of interdependence between human economies and natural ecosystems.
- **Econometrics:** applies mathematical and statistical methods to analyze data related to economic models.
- **Economic history:** the study of how economic phenomena evolved in the past.
- **Economic geography:** the study of the location, distribution and spatial organization of economic activities across the Earth.
- **Economic sociology:** the sociological analysis of economic phenomena.
- **Energy economics:** studies the relationship between supply and use of energy in societies.

- **Environmental economics:** concerned with issues related to degradation, enhancement, or preservation of the environment.
- **Entrepreneurial economics:** the study of the entrepreneur and entrepreneurship within the economy.
- **Feminist economics:** studies the relationship between feminism and economics.
- **Financial economics:** often simply referred to as finance, is concerned with the allocation of financial resources in an uncertain (or risky) environment.
- **Game theory:** is a branch of applied mathematics that studies strategic interactions between agents.
- **Human development theory:** a theory that merges older ideas from ecological economics, sustainable development, welfare economics, and feminist economics.
- **Industrial organization:** studies the strategic behaviour of firms, the structure of markets and their interactions.
- **Information economics:** examines how information (or a lack of it) affects economic decision-making.
- **International economics:** a branch of economics with three main sub-disciplines: international trade (a study of the exchange of goods and services across international boundaries), monetary theory (a study of monetary flows across countries) and international finance (a study of international financial markets).
- **Institutional economics:** focuses on understanding the role of human-made institutions in shaping economic behaviour.
- **Knowledge economics:** refers to the use of knowledge technologies (such as knowledge engineering and knowledge management) to produce economic benefits.
- **Labour economics:** seeks to understand the functioning of the market and dynamics of labour.
- **Land economics:** dedicated to the study of land use, natural resources, public utilities, housing, and urban land issues.
- **Law and economics (or economic analysis of law):** an approach to legal theory that applies methods of economics to law.
- **Managerial economics:** applies microeconomic analysis to specific decisions in business firms or other management units.

- **Mathematical economics:** application of mathematical methods to represent economic theory or analyse problems posed in economics.
- **Monetary economics:** concerned with the effects of monetary institutions and policy actions on economic variables.
- **Urban economics:** the economic study of urban areas.
- **Public finance:** deals with budgeting the revenues and expenditures of a public sector entity, usually government.
- **Public economics:** the study of economic issues that concern the public sector in a mixed economy.
- **Real estate economics:** the application of economic techniques to real estate markets.
- **Regional science:** concerned with analytical approaches to problems that are specifically urban, rural, or regional.
- **Resource economics:** includes the study of environmental economics, agricultural production and marketing, bioeconomics, community economic development, resource utilization, and environmental policy.
- **Socialist economics:** a term referring, in its descriptive sense, to the economic effects of nations with large state sectors where the government directs the kind and nature of production.
- **Welfare economics:** uses microeconomic techniques to simultaneously determine the allocative efficiency within an economy and the income distribution associated with it.

1.5 Ideological structure of economics

Economics has, no doubt, contributed to a variety of ideological structures. We can identify four key structures as follows:

Capitalist economy

Capitalism is an economic system in which property is owned by either private individuals or a corporation. Private ownership is sometimes used as a synonym for individual ownership. However, the term “private” may also be used to refer to collective ownership by individuals in the form of corporate ownership.

Communist economy

Communism is a socio-economic structure that promotes the establishment of a classless, stateless society based on common ownership of the means of production. It is usually considered to be a branch of socialism, a broad group of social and political ideologies, which draws on the various

political and intellectual movements with origins in the work of theorists of the Industrial Revolution and the French Revolution. Communism attempts to offer an alternative to the problems believed to be inherent with capitalist economies and the legacy of imperialism and nationalism. Communism states that the only way to solve these problems would be for the working class, or proletariat, to replace the wealthy bourgeoisie, which is currently the ruling class, in order to establish a peaceful, free society, without classes or government.

Corporate economy

Historically, corporatism or corporativism refers to a political or economic system in which power is held by civic assemblies that represent economic, industrial, agrarian, social, cultural, and professional groups. These civic assemblies are known as corporations (not necessarily the business model known as a 'corporation', though such businesses are not excluded from the definition either). Corporations are unelected bodies with an internal hierarchy; their purpose is to exert control over the social and economic life of their respective areas. Thus, for example, a steel corporation would be a cartel composed of all the business leaders in the steel industry coming together to discuss a common policy on prices and wages. When the political and economic power of a country rests in the hands of such groups, then a corporatist system is in place.

Socialist economy

Socialist economics is a broad and sometimes controversial term. A normative definition held by many socialists states that all socialist economic theories and arrangements are united by the desire to achieve greater equality and give the workers greater control of the means of production (though not private control). Within the limits set by these principles, however, socialist economics can take many different forms.

1.6 Economic systems

An economic system refers to the way in which production, allocation and distribution of goods and services are organized in a country. The main types of economic systems are: the mixed economy, the market economy and the command economy.

1. Market economy

A market is where buyers and sellers of a good or service exist. In a market economy, a consumer's decision to buy and at what price determines what is produced in an economy. Therefore, the forces of demand and supply tend to determine the allocation of economic resources. In this market, there is absence of government interventions. Market economies are also associated with private ownership of the means of production.

2. Planned economy

This is where the government central authority or planners take and implement most of the economic decisions. It is also known as a command economy because individuals respond to the commands or directives of the government or central planning authority. Unlike in a market economy where economic resources are privately owned, resources in a planned economy are publicly-owned.

3. Mixed economy

This is a system combining the characteristics of market economy and planned economy. Resources are both privately-owned and state-owned. However, the central government still plays a crucial role in influencing the allocation of resources through its regulations.

1.7 Concept of wants and needs

One of the most basic concepts of economics is *want* versus *need*. A need is something you have to have, something you cannot do without. A good example is food. If you do not eat, you will not survive for long. A want is something you would like to have. It is not absolutely necessary, but it would be a good thing to have. A good example is music. Now, some people might argue that music is a need because they think they cannot do without it. But you do not need music to survive.

These are general categories, of course. Some categories have both needs and wants. For instance, food could be a need or a want depending on the type of food. You need to eat protein, vitamins, and minerals. How you get them is up to you (and your family). You can eat meat, nuts, or beans to get protein. You can get fruits and vegetables to get vitamins and minerals. You can eat yoghurt to get other vitamins and minerals. You can eat bread to get still more vitamins and minerals. These basic kinds of foods are needs.

However, ice cream is a want. You do not really need to eat ice cream to survive. You can eat it to get some vitamins and minerals, but other foods such as milk and yoghurt give you more of those same vitamins and minerals without giving you the fat that ice cream does.



“Wants versus needs”

A discussion of the difference between a ‘need’ and a ‘want’ always generates some interesting debate that can sometimes be difficult to settle conclusively. When this happens, it is always important to take into account the context pertaining to any given situation. In some given context or situation, a given commodity can be regarded as a ‘need’ while in a different context the same commodity can be regarded as a ‘want’. Further, in other contexts, a given commodity can have both dimensions. For instance, food can assume both dimensions, depending only on its type. The important point, however, is not to lose sight of the basic difference between these two important concepts in economics.



Quiz on needs and wants

See the difference between need and want?

11. Is a house a want or a need?
 - ☐ Want
 - ☐ Need
12. Is a car a want or a need?
 - ☐ Want
 - ☐ Need
13. What about a radio? Want or need?
 - ☐ Want
 - ☐ Need
14. How about medicine? Want or need?
 - ☐ Want
 - ☐ Need
15. Finally, what about school? Want or need?
 - ☐ Want
 - ☐ Need

ANSWERS:
 Strictly speaking, there is no right or wrong answers to this quiz. However, the following responses may represent the context of the average African worker.
 1: Need; 2: Want; 3: Want; 4: Want; 5: Need

1.8 Concept of goods and services

One of the most basic ideas in economics is goods and services. More than anything else, money is spent on goods and on services. It is important to know the difference between the two.

A good is something that you can use or consume, such as food or books or a car or clothes. You buy a good with the idea that you will use it, either just once or over and over again. A good is tangible.

A service is something that someone does for you, such as giving you a haircut or even teaching you economics. You do not really get something you can touch, such as a book.

1.9 Why all the tables and charts in economics?

Economics can be a complicated subject. You have to know about money and time and business, and supply and demand, and wants and needs. You have to be able to read charts, graphs and tables. Why does economics get to have all those charts, graphs and tables?

Economics needs lots of tables, charts and graphs because the subject uses more numbers and tracks more trends than other social studies. Economics, with its dependence on endlessly comparing present day numbers to month-ago numbers, needs a way to show the data other than just listing numbers in lines of type. And because many people can digest information more easily when they see it on a graph, economics can accommodate them by showing graphs, tables and charts that put a visual face on what is essentially a bunch of numbers.

1.10 Concept of interdependence

Another of the most basic terms in the study of economics is interdependence. It means “dependent on others for some needs.” In other words, you cannot produce everything you need.

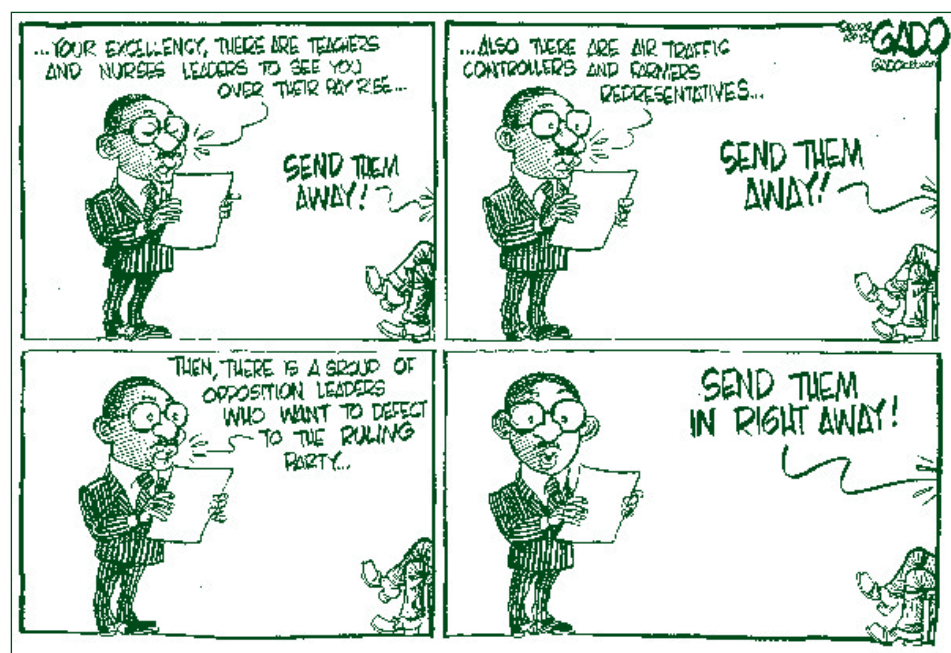
If you live on a farm, you might grow all your own fruits and vegetables. You might have cows and chickens to give you milk and eggs. You might have goats or sheep to give you meat. You might not ever need to go to a grocery store for food. But you probably do not make your own farm equipment. You are dependent on someone else for those things. If someone else did not make the hoes and the rakes and the tractors that your family uses, you would not be able to produce all that food.

Goods such as food, clothing, radios, TVs, and books are made by people all around the world. Some people can make things better than others. Some foods grow more easily in some countries than in others. Interdependence is the idea that you as a person depends on other people for certain things. The same is true of families, towns, and even countries.



Points for general discussion: Elements of economics

- Economies are social creations—contrary to what mainstream economists might have you believe, there is nothing inevitable or ‘natural’ about them.
- There have been many different economic systems throughout the history of humankind: hunter gatherer, feudal, communist, capitalist. Capitalism is a relatively young economic system, emerging around 400 years ago (1600s). In contrast, hunter gatherer systems survived for many thousands of years.
- Since the economy is a social creation, if we are unhappy with its consequences, we can change it.
- The current dominant economic system is capitalism, characterized by private ownership, production for profit, wage labour, market exchange, commodity production (goods and services produced for sale in the market as opposed to being used).
- The current variant of capitalism is neo-liberalism: ‘free trade’, free market, minimal government.



Daily Nation, 14 February 2002, <http://www.gadonet.com>



Activity: Trade unions as economic players

Time required: 1 hour

Objectives

1. To show that economics involves power relations between people.
2. To identify the role of a trade union as an economic player in your country.

Tasks

1. Give explicit examples of the following list of key economic players in your country
 - Farmers
 - Transporters
 - Informal sector operators
 - Professionals (economists, lawyers, doctors, teachers, engineers, etc)
 - Employers, chambers of commerce
 - Government
 - Banks and other domestic financial institutions
 - International financial institutions (World Bank, IMF, African Development Bank)
 - Investors
 - Non-governmental organizations (NGOs) and social groups
 - Multinational corporations (MNCs)
 - Unpaid workers in the household, who provide care for children, the sick, and the elderly
 - Trade unions
 - Children
 - Parents
 - Members of parliament
 - Women
 - University students

2. Are there any additional economic players that should be on the list?

If the answer is yes, then add on the list below:

-
-
-
-
-
-

3. Write up the list of the five most influential economic players in your country.
4. Respond to the following questions:
 - Why were these five chosen above the others?
 - Where does their power come from?
 - How is it exerted? In what ways do they use their power?

Appendix: Group activity on shifts in economic ideology(1 hr)²**Objectives**

- To trace shifts in economic models/ideologies and policies: Classical, Keynesian, Neoliberal.
- To examine the neoliberal fixation on inflation even at the cost of high unemployment.
- To explain how high levels of unemployment and inflation affect workers, industrial capital and financial capital/wealth holders.

(i) Input-Shifts in economic ideology (15 min)**The struggle over economic ideologies**

Economics is sometimes called the ‘queen of the social sciences’, by which is meant that it is closer to a ‘real’, ‘hard’ science, such as physics, chemistry or biology, than any of the other social sciences. In reality, economic theories are not based on natural laws analogous to gravity or centrifugal force. Economic theories are social constructions, which means they are made by people. The dominant economic model or paradigm has changed throughout history. We have seen hunter-gatherer, mercantilist, feudal, slave-based, communist, and capitalist economies—and within each of these there are many variations. In fact, there are always numerous economic paradigms in competition with each other for recognition and influence—think of the Cold War: capitalism vs communism. The outcome has more to do with power, politics and struggle than science. We will focus here on the recent shifts in the dominant capitalist economic paradigms and policies.

From classical to keynesian economics

Prior to the Great Depression in the 1930s, the Classical school dominated capitalist economics. The Classical school believed that markets were ‘self-equilibrating’, which is to say that they will right themselves if thrown off balance. They looked at the upswings and downswings of the business cycle as natural and self correcting.

For instance, according to Classical theory, here is a simplified story of what should happen in the case of a recession: Business investment is down, workers have been laid off and unemployment is high. Workers, worried about their jobs, are willing to settle for lower wages. Falling demand for goods, loans (for business investment) and office space prompts lower prices, interest rates and rents. As the cost of doing business (wages, inputs, interest, rent) falls, the conditions of profitability improve and businesses eventually start investing and hiring workers, who then create more demand and stimulate further investment, bringing the economy out of the recession. The Classical school’s macro-policy prescription then

² Extracted from African Labour Educators Network (ALLEN), forthcoming.

is that the government should do nothing. The economy will right itself as long as the government does not interfere and distort market signals.

But then along came the Great Depression of the 1930s and the 'do nothing' policy prescription saw a recession deepen into a depression that went on and on. British economist, John Maynard Keynes (pronounced canes) argued that although wages, prices, interest and rents were falling as predicted by Classical theory, business investment would not revive because businesses had no confidence that they would be able to sell their goods and services given the economic depression. Keynes argued that the government must step in to 'jump start' the economy by stimulating demand. The Great Depression ushered in a period of Keynesian macroeconomic policy, which legitimized the active role of government in stabilizing the economy using fiscal and monetary policy.

Governments, including the US and the UK, implemented public works programmes to simultaneously provide employment and to jump start the economy, but they were a drop in the bucket compared to the depth of the Great Depression. It was really only the massive public spending on the Second World War that pulled the economy out of its slump.

Still, Keynesian macro policies had displaced those of the Classical school. Not only was government intervention in the economy legitimized, but also social welfare programmes that addressed 'market failures'—socio-economic problems that the market could not remedy—such as affordable housing, unemployment, poverty and healthcare for the poor. Social welfare programmes also served as an 'automatic stabilizer', which meant that if the economy went into decline, government spending would automatically rise in the form of unemployment benefits and other social welfare payments, thereby countering the economic downturn.

From keynesian to neoliberal economics

The Keynesian economic paradigm held sway through the mid-1970s when it was undermined by the problem of stagflation—high inflation and unemployment at the same time. Recall the Phillips curve (see Myth 1) in which inflation and unemployment could be balanced off one another. With stagflation, the traditional Keynesian prescriptions offered no relief—only more pain. A central cause of stagflation was the oil shocks in the 1970s, which saw the price of oil rise steeply due to the ability of OPEC (Organization of Petroleum Exporting Countries) to curtail the supply of oil. The rise in the cost of oil led to an across-the-board increase in the cost of production, causing inflation, but also slimmer profits, cutbacks in investment and rising unemployment, thus the simultaneously high levels of inflation and unemployment.

Stagflation was finally overcome in the early 1980s when the US Central Bank deliberately created the worst recession since the Great Depression and the effect was felt worldwide. Unemployment and economic stagnation reached such unbearable levels that inflation was finally crushed. To put it simply, the Keynesian goal of achieving growth, full employment and low inflation was thrown out in favour of keeping inflation under control, no matter the cost on the unemployment front.

Conservative economists and ideologues were able to exploit the economic crisis of the late 1970s by ushering in a new economic paradigm—in the US it was called Reaganomics, or supply-side economics; in the UK it was called Thatcherism, and now we would recognize it as neoliberalism.

In many ways, neoliberalism goes back to the Classical school: markets and the economy are self-equilibrating and the government should not intervene in the economy. They would argue against activist fiscal and monetary policy as well as against social welfare programmes. In this view, what is important is creating conditions that encourage a conducive business investment—free markets, free trade, minimal government intervention, de-regulation, privatization, cutbacks in social welfare, business-friendly unions—these are all hallmarks of neoliberal economics. Neoliberal policy places a priority on controlling inflation in order to achieve growth, while full employment is not a major priority. We will look at neoliberalism in more detail below.

Some aspects of the European Monetary Union (EMU) fall in line with the neoliberal bias against government intervention in the economy. Countries that have joined the EMU have ceded control over monetary policy to the European Central Bank, which has a mandate to keep inflation under 2 per cent, while full employment is not a priority. They are also obliged by the Stability and Growth Pact to limit national deficits to under 3 per cent of GDP, which severely constrains their ability to use expansionary fiscal policy. Many people are concerned about the loss of national sovereignty (the ability of governments to exercise power over the national economy) as governments' ability to use fiscal and monetary policy has been extremely restricted within the Eurozone.

(ii) Small group exercise—macro policy shifts (40 min)

With the rise of neoliberalism, there has been a shift in macroeconomic policy from targeting both moderate inflation and unemployment to prioritizing inflation. This exercise explores why, and who are the winners and losers.

Write up the table below on flip chart. Break participants into small groups and give them 10-15 minutes to answer the following questions:

What do you think the impacts of unemployment and inflation are on these different groups? Good, Bad, or Moderate.

Be ready to explain your group's answers.

	Unemployment	Inflation
Workers		
Industrial capital		
Financial capital and wealth holders		

Discussion (15 min)

Come back into a big group and ask for their responses. In the interest of time, there is no need for every group to give all their answers. Fill in the table with the correct answers and explain if necessary.



Facilitator's outlines

Impact of unemployment on:

Workers: Bad—due to Job loss, downward pressure on wages, worsening working conditions, reduced union strength.

Industrial capital: Good—A moderate amount of unemployment is good for maintaining worker discipline. In the US and many European countries, there is a positive relationship between unemployment and productivity (i.e. unemployment goes up, worker productivity goes up).

Financial capital and wealth holders: Moderate—Not a primary concern unless unemployment is really high, which would likely mean the economy is in a recession.

Impact of moderate inflation on:

Workers: Moderate—While inflation erodes the value of a worker's salaries and wages, a small amount of inflation is preferable to unemployment. Also, workers often receive a cost of living adjustment to make up for inflation.

Collective bargaining and wage negotiation may also lead to inflationary effects if there is too much or rapid increases on wages and other monetary benefits to workers.

Industrial capital: Moderate to good—High inflation can be destabilizing, but a small amount is alright. It can boost profits if wages can be held down while the selling price of the output rises with inflation.

Financial capital and wealth holders: Bad—The value of a loan is eroded by inflation. Even with interest charges, the value is reduced by the rate of inflation. Wealth is eroded by inflation (Note: debt holders benefit if their income is rising with inflation).

Upshot

The overriding concern about the rate of inflation reflects neo-liberal ideology, which is expressed in the need for 'market discipline' (even if that sometimes means high unemployment), and the need for 'fiscal rectitude' and 'tight money' (even if that means holding wages down and implementing government cutbacks). It also happens to be strongly in the interest of financial capital and the wealthy.



Myth 1: There is a tradeoff between unemployment and inflation

Some economists and politicians urge governments to abandon inflationary policies arguing that this would lead to severe unemployment. This doctrine has its roots with the Keynesian economists who stipulated that manipulating and fine-tuning deficits and government spending would bring growth and full employment without inflation.

The tradeoff between inflation and unemployment was further developed by a British economist A.W. Phillips who correlated wage rate increases with unemployment. Phillips claimed that the two move inversely: the higher the increases in wage rates, the lower the unemployment.

However, modern statistical evidence violates the Phillips curve as well as logical theory. For example, during the 1950s, inflation in the US was only about one to two per cent per year, and unemployment hovered around three or four per cent, whereas later unemployment ranged between 5 and 11 per cent and inflation between 5 and 13 per cent.

Similarly, since 2000, empirical evidence in Zimbabwe shows that both inflation and unemployment have increased sharply and severely. If anything, there has been a reverse Phillips curve. There has been anything but an inflation-unemployment tradeoff.

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Part II: Elements of economics

Unit 2: Key principles of microeconomics

Topics

“A banker is a fellow who lends you his umbrella when the sun is shining and wants it back the minute it begins to rain.”

*Mark Twain,
American
humourist,
satirist, lecturer
and writer;
(1835-1910)*

The purpose of this unit on key principles of microeconomics is to give trade unionists an understanding of the principles of economics that apply to the functions of individual decision makers, both consumers and producers, within the economic system. This unit places primary emphasis on:

- the nature and functions of product markets,
- the study of factor markets, and
- the role of government in promoting greater efficiency and equity in the economy.

The unit is divided into four main topics and some aspects of them that unionist may choose to explore:

1. Basic economic concepts

- the need to make choices
- opportunity costs
- trade-offs
- different types of economies determine which goods and services to produce, how to produce them, and to whom to distribute them
- absolute and comparative advantage

2. Nature and functions of product markets

- supply and demand models
- theory of the firm

3. Factors of production and factor payments

- the concepts of supply and demand to markets for factors

4. Market failure

- conditions for economic efficiency
- ways in which externalities, public goods, and the market distribution of income create market failures
- effectiveness of government policies such as subsidies, taxes, quantity controls, and public provision of goods and services

2.1 Basic economic concepts

(a) Microeconomics versus macroeconomics

Microeconomics is a branch of economics that studies how individuals, households and firms make decisions to allocate limited resources, typically in markets where goods or services are being bought and sold. One of the goals of microeconomics is to analyze market mechanisms that establish relative prices amongst goods and services and allocation of limited resources amongst many alternative uses. Microeconomics analyses market failure, where markets fail to produce efficient results.

Microeconomics examines how decisions and behaviours affect the supply and demand for goods and services, which determines prices; and how prices, in turn, determine the supply and demand of goods and services. Macroeconomics (a subject to be discussed fully in Unit III), on the other hand, involves the sum total of economic activity, dealing with the issues of growth, inflation and unemployment, and with national economic policies relating to these issues, and the effects of government actions (such as changing taxation levels) on them.

(b) Opportunity cost

In any society, the basic economic problem is how to deal with limited resources in the face of unlimited wants. Because resources are limited, individuals and society must choose how best to use them. As such, making prudent choices requires sacrificing one option or opportunity for another. This logic expresses a fundamental notion in economics—that every choice made is at the expense or cost of another. Economists use the term opportunity cost to denote the value of the next best alternative forgone.

In economics, the “opportunity cost” of a resource is the value of the next-highest valued alternative use of that resource. If, for example, you spend time and money going to visit a friend, you cannot spend that time at attending a union meeting and you cannot spend the money (fare used) on something else. If your next-best alternative to visiting the friend is attending the union meeting, then the opportunity cost of making the visit is the money spent plus the benefit you forgo by not attending the union meeting.

This simple concept has powerful implications. It implies, for example, that even when governments subsidize university education, most families still pay substantial amounts to cover the cost of education. As an example, take a student who pays Sh20,000 as university fees each year. Assume that the government subsidy to the university amounts to Sh50,000 per student. It looks as if the cost is Sh70,000 and the student pays less than half. The true cost is Sh70,000 plus the income the student forgoes by attending school rather than working. If the student could have earned Sh150,000 per year, then the true cost of the education is Sh70,000 plus Sh150,000. Of this Sh220,000 total, the student’s family pays Sh170,000 (Sh150,000 plus Sh20,000).

What about the cost of room and board while attending university? This is not a true cost of attending university at all, because whether or not the student attends school, someone must pay room and board.

Opportunity cost is a key concept in economics because it implies the choice between desirable, yet mutually exclusive results. It has been described as expressing the basic relationship between scarcity and choice. The notion of opportunity cost plays a crucial part in ensuring that scarce resources are used efficiently. Thus, opportunity costs are not restricted to monetary or financial costs; the real cost of output forgone, lost time, pleasure or any other benefit that provides utility should also be considered.

Example: Opportunity cost of building a hospital

If the city of Harare decides to build a hospital on vacant land it owns, the opportunity cost is the value of the benefits forgone of the next best thing, which might have been done with the land and construction funds instead. In building the hospital, the city has forgone the opportunity to build a sports stadium on that land, or a parking lot, or the ability to sell the land to reduce the city's debt, since those uses tend to be mutually exclusive. Also included in the opportunity cost would be what investments or purchases the private sector would have voluntarily made if it were not taxed to build the hospital. The total opportunity costs of such an action can never be known with certainty (and are sometimes called "hidden costs" or "hidden losses"; what has been prevented from being produced cannot be seen or known). Even the possibility of inaction is a lost opportunity (in this example, to preserve the scenery as is for neighbouring areas, perhaps including areas that it itself owns).

Note that opportunity cost is not the sum of the available alternatives, but rather the benefit of the single, best alternative. Possible opportunity costs of the city's decision to build the hospital on its vacant land are the loss of the land for a sporting centre, or the inability to use the land for a parking lot, or the money that could have been made from selling the land, or the loss of any of the various other possible uses—but not all of these in aggregate. The true opportunity cost would be the forgone profit of the most lucrative of those listed.



Question and answers: Calculating opportunity costs

Question: What is the opportunity cost of a farmer who chooses to farm his land rather than rent it to neighbours?

Answer: The opportunity cost is the forgone profit from renting.

Question: What is the opportunity cost of attending university?

Answer: The opportunity cost is the lost wages a student could have earned in the workforce, rather than the cost of tuition, books, and other requisite items (whose sum makes up the total cost of attendance).

Question: What is the opportunity cost of a vacation in Victoria Falls?

Answer: It might be the downpayment money for a house.

(c) Trade offs

A **trade-off** usually refers to losing one quality or aspect of something in return for gaining another quality or aspect. It implies a decision to be made with full comprehension of both the upside and downside of a particular choice.

When choices are made (collectively or by an individual) to accept having less of one thing in order to get more of something else, the results are called trade-offs. For example, when one is allocating (limited) funds, the trade-off usually involves reduced spending for some purposes in order to be able to spend more for other more urgent purposes.

However, the concept does not apply only (or even primarily) to decisions involving money. A student faced with the choice of spending Saturday studying for a Political Economy exam or shopping at The Mall makes a trade-off of shopping time for study time in deciding how many hours to study and how many to spend shopping. Society also makes trade-offs—for example, between its need for a more plentiful supply of energy and its need to prevent excessive deterioration of the environment caused by energy production technologies.

Evaluating trade-offs, when done carefully and systematically, involves comparing the costs and benefits of each of the available alternatives with each other. Most choices (and thus most trade-offs) are not all-or-nothing decisions; rather they typically involve small changes at the margin—a little more of this at the cost of a little less of that.

(d) Common economic problems

Common problems among different types of economies include:

- what goods to produce and in what quantities,
- how to produce them, and
- for whom to produce them.

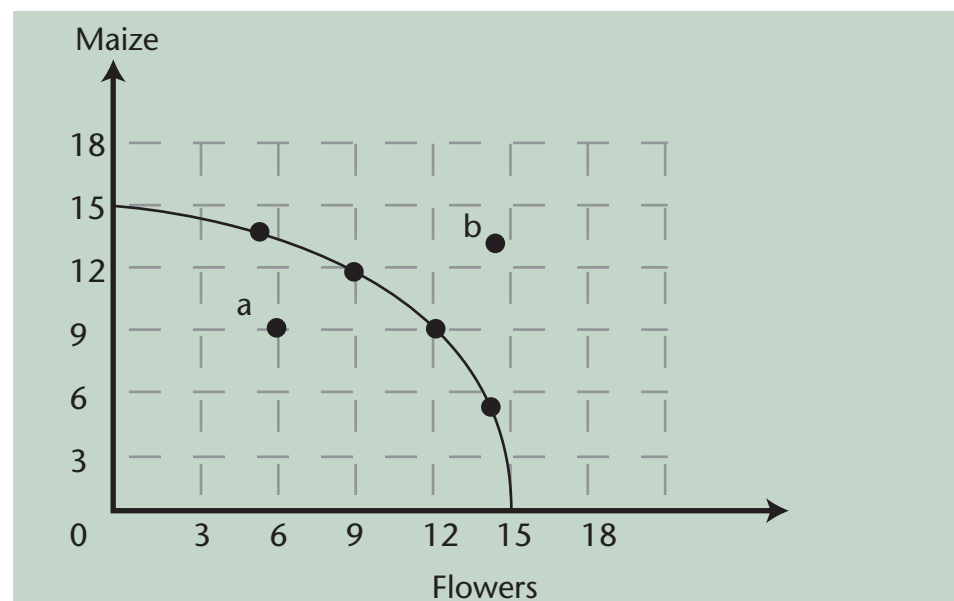
An analytical tool for addressing these problems is the production-possibility curve (PPC). In the simplest case, let us assume an economy that can produce just two goods, flowers and maize. In a given period of time, the simple economy may choose to produce only flowers, only maize, or a combination of the two according to the following table:

Table 2.1: Production possibility table

Flowers ('000 bunches)	Maize ('000 bushels)
0	15
5	14
9	12
12	9
14	5
15	0

The production possibility curve (PPC) is the curve resulting when the above data is graphed, as shown below:

Figure 2.1: Production possibility curve



The PPC shows all efficient combinations of output for this simple economy when the factors of production are used to their full potential. The economy could choose to operate at less than capacity somewhere inside

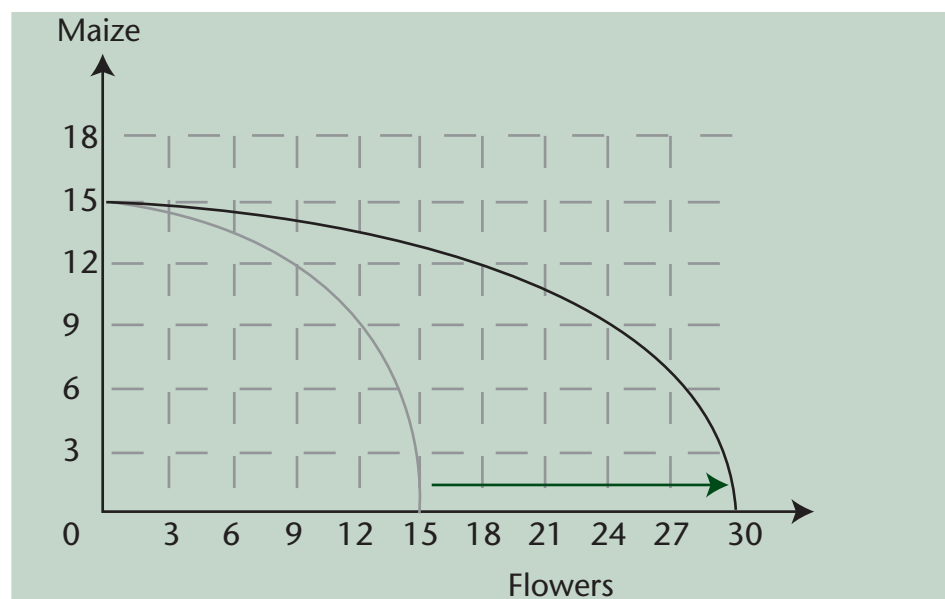
the curve, for example at point *a*, but such a combination of goods would be less than what the economy is capable of producing. A combination outside the curve, such as point *b* is not possible since the output level would exceed the capacity of the economy.

The shape of this production possibility curve illustrates the principle of increasing cost. As more of one product is produced, increasingly larger amounts of the other product must be given up. In this example, some factors of production are suited to producing both flowers and maize, but as the production of one of these commodities increases, resources better suited to production of the other must be diverted. Experienced producers of flowers are not necessarily efficient maize producers, and maize producers are not necessarily efficient producers of flowers, therefore the opportunity cost increases as one moves towards either extreme on the curve of production possibilities.

Suppose a new technique was discovered that allowed the producers of flowers to double their output for a given level of resources. Further, suppose that this technique could not be applied to maize production. The impact on the production possibilities is shown in Figure 2.2. In the figure, the new technique results in flowers production that is double its previous level for any level of maize production.

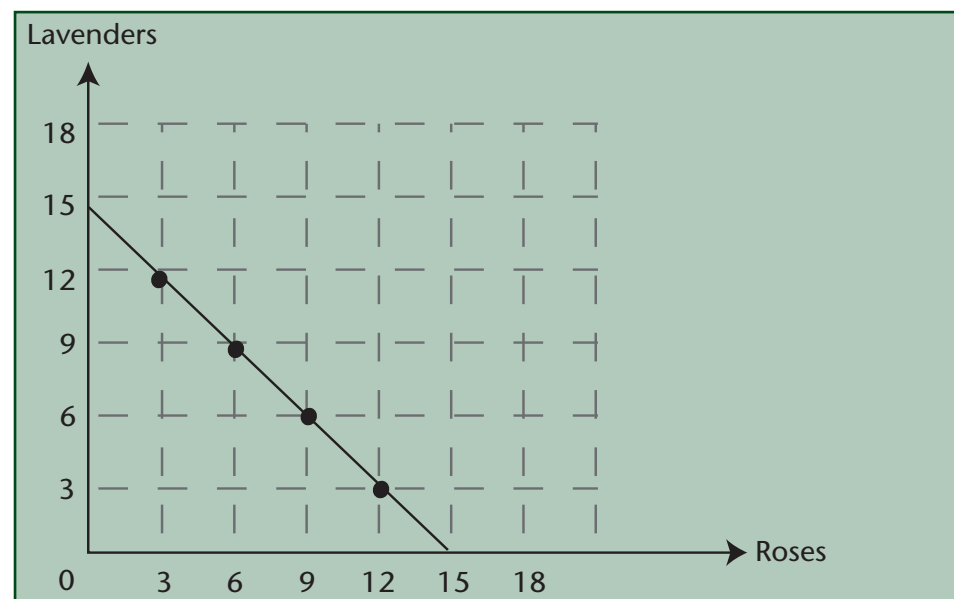
Finally, if the two products are very similar to one another, the production possibility curve may be shaped more like a straight line. Consider the situation in which only flowers are produced. Let us assume that two types of flowers are produced—roses and lavenders—and that these two types of flowers use the same fertilizer and farming process. The same factors of production can produce either type of flowers equally efficiently. The production possibility curve then would appear as shown in Figure 2.3.

Figure 2.2: Shifted production possibility curve



Note that to increase production of roses from 0 to 3000 bunches, the production of Lavender must be decreased by 3000 bunches. This opportunity cost remains the same even at the other extreme, where increasing the production of roses from 12,000 to 15,000 bunches still requires that of Lavender to be decreased by 3000 bunches. Because the two flowers are almost identical in this case, and can be produced equally efficiently using the same resources, the opportunity cost of producing one over the other remains constant between the two extremes of production possibilities.

Figure 2.3: Production possibility curve for very similar products





Activity: Understanding how the economy works

Time required: (1 hour)

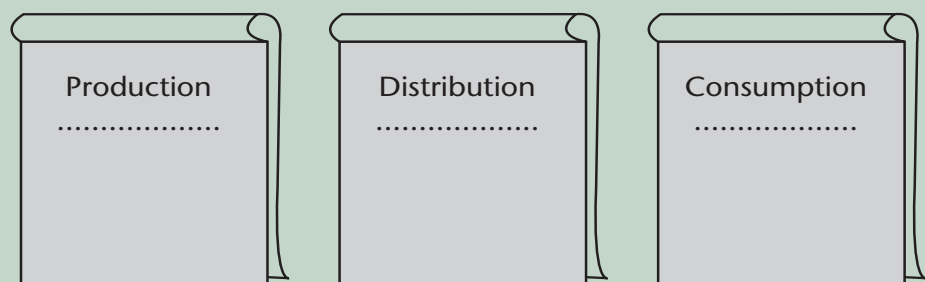
Objectives

1. To help understanding of the economy and the variety of activities that make up an economy.
2. To identify key components of an economy: production, distribution, consumption, and the invisible portion of each of these components.
3. To review a formal definition of "economy."

Tasks

1. Ask participants to identify and list five economic activities (both paid and unpaid) they have been involved in over the past few days. Remember that economic activities are any financial transactions, job-related operations, or major domestic chores undertaken. There are no wrong or right answers.
2. Let them organize the identified activities into three categories: production, distribution, consumption (see below).

Components of an economy



Note:

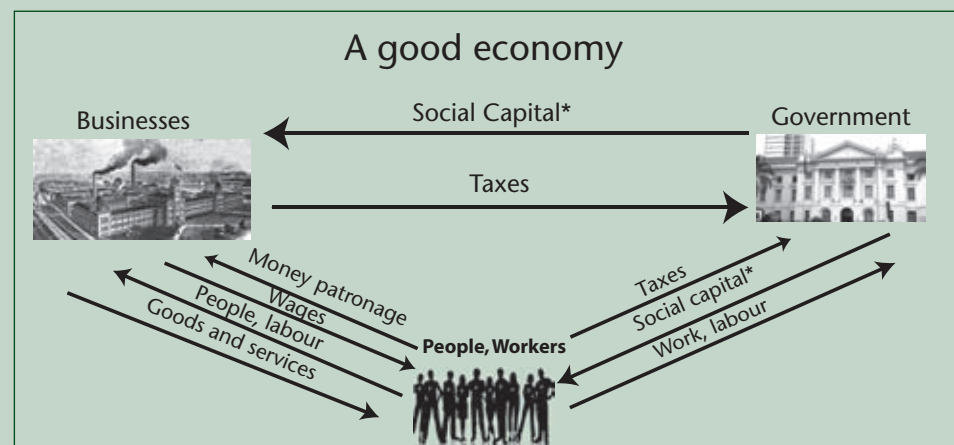
Production activities could be anything to do with the building or making of a product or performing a task or productive service. If the individual receives remuneration for this work, it is considered PAID, and goes above the flap on the top half of the sheet. For example, assembling cars, sewing in a factory, working in an office, or digging a ditch as part of a government job are all examples of paid production. UNPAID production could be subsistence agriculture/farming or fishing or unpaid family work, such as taking orders for your husband's carpentry business. Unpaid examples get taped to the bottom half of the sheet for production.

Distribution activities involve helping to get the product from the producer to the consumer. PAID distribution examples include working in or running a store; driving a delivery truck, bus, or taxi; handling cargo in a port or airport; or selling goods in a market. UNPAID examples include hauling firewood or water to home, being an unpaid worker in a store, or bartering with a neighbour. These unpaid examples go under the bottom half of the sheet for distribution.

Consumption activities involve the purchasing and use of a product or service. Consumption can take place in the home, at work, or by the government. Examples of PAID consumption and care-taking activities, include hiring a tailor or seamstress to mend your clothes, teaching students, buying inventory for your store or office, eating at a restaurant, and being a domestic servant (for pay). Examples of UNPAID activities in this category are cooking a meal at home, painting your home, cleaning your home, giving a child a haircut at home, volunteering in your community, taking care of a sick neighbour, or doing laundry. These examples go under the bottom half of the sheet for consumption.

3. The figure below shows how a real economy works.

Figure 2.4: A good economy



The chart above shows an example of a good economy. Each of the links in the chains is very important. If just one of the arrows is taken away, the economy will fall apart. The chart below shows what would happen if taxes from businesses to the government are taken away.

Figure 2.5: A failed economy



The absence of taxes from the businesses would result in a total economic crash. Since the government cannot get enough money, it must raise taxes for the few payers left (the people). This results in the people having little money to spend on businesses' goods and services, and without enough to provide social capital. Now, people cannot get educated to run businesses, therefore people cannot work, leaving people poor and unemployed, and the businesses cannot make or sell goods. The businesses do very poorly, and investors in businesses are left in debt. The economy simply crashes.

(e) Principles of comparative advantage

Comparative advantage is a key economic concept in the study of trade and is usually attributed to the classical economist David Ricardo. The principle of comparative advantage explains how trade can benefit all parties involved (countries, regions, individuals and so on), as long as they produce goods with different relative costs. The net benefits of such an outcome are called gains from trade.

Adam Smith had used the principle of absolute advantage to show how a country can benefit from foreign trade if the country has the lowest absolute cost of production in a good (i.e., it can produce more output per unit of input than any other country). The principle of comparative advantage shows that what matters is not the absolute cost, but the opportunity cost of production. The opportunity cost of production of a good can be measured as how much production of another good needs to be reduced to increase production by one more unit.¹

The principle of comparative advantage shows that even if a country has no absolute advantage in any product and it is not the most efficient producer for any good, the disadvantaged country can still benefit from specializing in and exporting the product(s) for which it has the lowest opportunity cost of production.

The following hypothetical example explains the reasoning behind the theory. Two men live alone in an isolated island. To survive they must undertake a few basic economic activities such as water carrying, fishing, cooking and shelter construction and maintenance. The first man is young, strong, and educated and is faster, better, more productive at everything. He has an absolute advantage in all activities. The second man is old, weak, and uneducated. He has an absolute disadvantage in all economic activities. In some activities, the difference between the two is great; in others it is small.

Is it in the interest of either of them to work in isolation? No, specialization and exchange (trade) can benefit both of them.

How should they divide the work? According to comparative, not absolute advantage, the young man must spend more time on the tasks in which he is much better and the old man must concentrate on the tasks in which he is only a little worse. Such an arrangement will increase total production and/or reduce total labour. It will make both of them richer.

¹ It is argued that Hong Kong and Singapore are good examples of countries that do not have any absolute advantage in any product, but command considerable exports.



Activity: Dr freetrade lecture on comparative advantage

“Hello and thank you so much for coming. After hearing the following analysis, I’m sure you will come to understand that free trade is a win-win situation. In order to explain this, we will be learning about the theory of comparative advantage. It is to the credit of the theory that it has stood the test of time and still underpins trade policies today. To illustrate the theory of comparative advantage, I’ll need four volunteers to help me act out the scenario. You two are farmers in Riceland—one is a rice farmer and one is a bean farmer (Assign roles). You two are farmers in Beanland—one is a rice farmer and one is a bean farmer.

Now, Riceland is better suited to growing rice than beans. The rice farmer can grow twice as much rice as beans. Beanland is better suited to growing beans than rice. One worker can grow twice as much beans as rice. However, since rice and beans are complementary proteins, each country eats both rice and beans.

- Without trade, Riceland’s rice farmer produces 1 cup of rice (rice farmer fills a cup with rice) and the bean farmer grows $\frac{1}{2}$ cup of beans (bean farmer fills half a cup). Beanland’s bean farmer produces 1 cup of beans (bean farmer fills a cup) and the rice farmer produces a $\frac{1}{2}$ cup of rice (bean farmer fills half a cup).
- Now, Riceland and Beanland decide to specialize in the crop in which they have a comparative advantage and trade. So, Riceland’s two farmers produce two cups of rice (fill 2 cups), and Beanland’s two farmers produce two cups of beans (fill 2 cups).
- They trade one cup of beans for one cup of rice. After trade, each country has one cup of each.

You can see the outcome before and after specialization and trade. Obviously, everyone is better off after each country has exploited its comparative advantage and engaged in trade. And that, ladies and gentlemen is how it is in the real world. Thank you for the opportunity to speak here today.”

	Riceland—2 workers produce:	Beanland—2 workers produce:
Before trade	1 cup of rice and $\frac{1}{2}$ cup of beans	1 cup of beans and $\frac{1}{2}$ cup of rice
Specialization with trade	2 cups of rice	2 cups of beans
	Trade 1 cup of rice for 1 cup of beans	Trade 1 cup of beans for 1 cup of rice
	Now, they have 1 cup of rice and 1 cup of beans	Now, they have 1 cup of rice and 1 cup of beans

2.2 Nature and functions of product markets

In economics, the product market is a mechanism that brings together buyers and sellers of goods and services. For us to understand product markets, we need to learn about supply and demand.

(a) Supply and demand models

Supply and demand is perhaps one of the most fundamental concepts of economics and it is the backbone of a market economy. Supply and demand are really two separate things, but they are almost always talked about together.

Supply is how much of a good or a service is available. For example, if you have 9 office desks to sell, then your supply of office desks is 9. If you have 60 mangoes, then your supply of mangoes is 60.

Demand is how much of a good or a service people want. Demand can also be measured using the simple numbering system, just like the supply one. If 8 union branches want office desks, then we can say that the demand for office desks is 8. If 40 people want mangoes, then we can say that the demand for mangoes is 40.

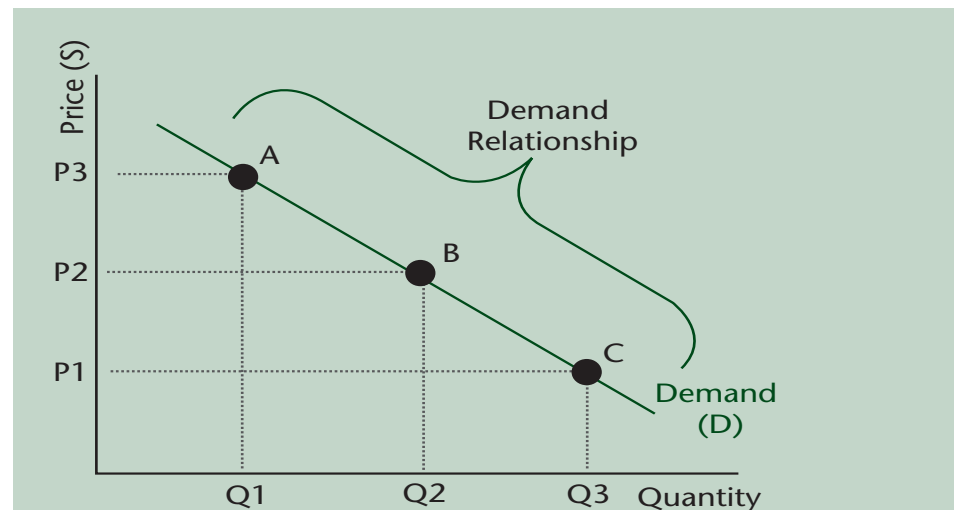
In economics, supply and demand describes market relations between prospective sellers and buyers of a good. The supply and demand model determines price and quantity sold in a market. This model is fundamental in microeconomic analysis and is used as a foundation for other economic models and theories. It predicts that in a competitive market, price will function to equalize the quantity demanded by consumers and the quantity supplied by producers, resulting in an economic equilibrium of price and quantity. The model incorporates other factors changing equilibrium as a shift of demand and/or supply.

The relationship between demand and supply underlie the forces behind the allocation of resources. In market economy theories, demand and supply forces will allocate resources in the most efficient way possible. How? Let us take a closer look at the law of demand and the law of supply.

The law of demand

The law of demand states that, if all other factors remain equal, the higher the price of a good, the less people will demand that good. In other words, the higher the price, the lower the quantity demanded. The amount of a good that buyers purchase at a higher price is less because as the price of a good goes up, so does the opportunity cost of buying that good. As a result, people will naturally avoid buying a product that will force them to forgo the consumption of something else they value more. The figure below shows that the curve is a downward slope.

Figure 2.6: Law of demand



A, B and C are points on the demand curve. Each point on the curve reflects a direct correlation between quantity demanded (Q) and price (P). Therefore, at point A, the quantity demanded will be Q1 and the price will be P1, and so on. The demand relationship curve illustrates the negative relationship between price and quantity demanded. The higher the price of a good the lower the quantity demanded (A), and the lower the price, the more the good will be in demand (C).

What determines the quantity demanded?

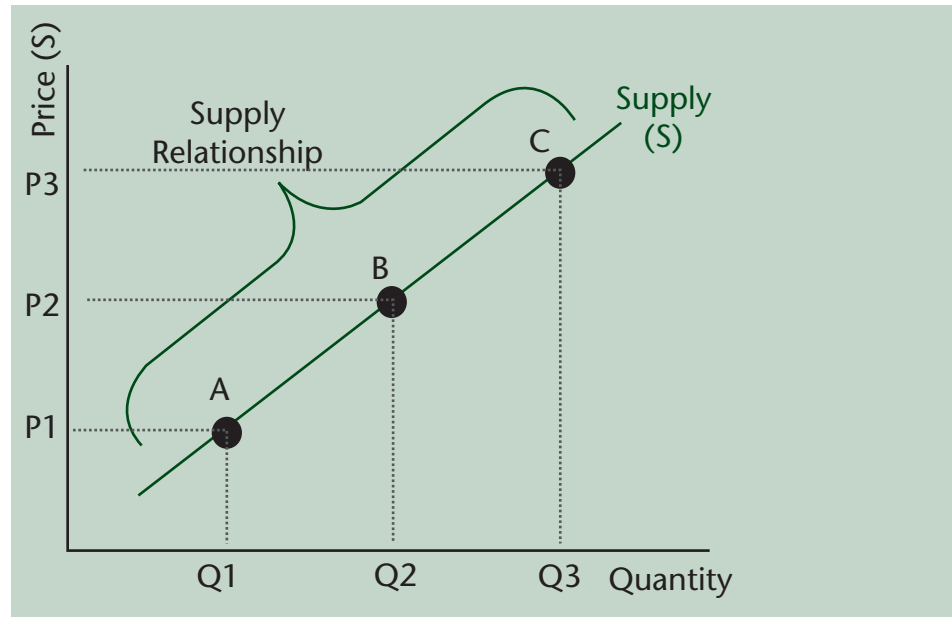
How much of a commodity people will demand will be dependent upon a number of factors:

- the price of the desired commodity
- the prices of related commodities—what are the possibilities of substitution?
- the average income
- tastes and shifts in life styles
- the distribution of income among the people
- the size of the population

The law of supply

Like the law of demand, the law of supply demonstrates the quantities that will be sold at a certain price. However, unlike the law of demand, the supply relationship shows an upward slope. This means that the higher the price, the higher the quantity supplied. Producers supply more at a higher price because selling a higher quantity at a higher price increases revenue.

Figure 2.7: Law of supply



A, B and C are points on the supply curve. Each point on the curve reflects a direct correlation between quantity supplied (Q) and price (P). At point B, the quantity supplied will be Q2 and the price will be P2, and so on.

Unlike the demand relationship, however, the supply relationship is a factor of time. Time is important to supply because suppliers must, but cannot always, react quickly to a change in demand or price. Therefore, it is important to try and determine whether a price change that is caused by demand will be temporary or permanent.

Let us say there is a sudden increase in the demand and price for umbrellas in an unexpected rainy season; suppliers may simply accommodate demand by using their production equipment more intensively. If, however, there is a climate change, and the population will need umbrellas year-round, the change in demand and price will be expected to be long term; suppliers will have to change their equipment and production facilities in order to meet the long-term levels of demand.

The supply curve may also change because of:

- improvements or decline in productivity and technology
- adjustment in profit expectations of producers
- changes in the prices of other commodities, including the production of competitors
- changes in the prices of inputs, such as wage increases

Supply and demand relationship

Now that we know the laws of supply and demand, let us turn to an example to show how supply and demand affect price.

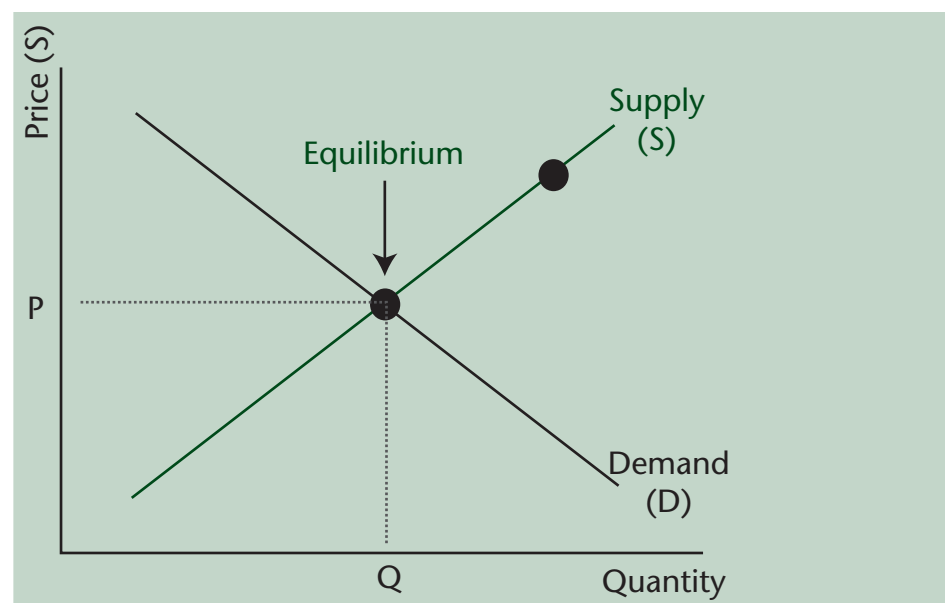
Imagine that a special edition CD of your favourite band is released for Nam\$20. Because the record company's previous analysis showed that consumers will not demand CDs at a price higher than Nam\$20, only ten CDs were released because the opportunity cost is too high for suppliers to produce more. If, however, the 10 CDs are demanded by 20 people, the price will subsequently rise because, according to the demand relationship, as demand increases, so does the price. Consequently, the rise in price should prompt more CDs to be supplied as the supply relationship shows that the higher the price, the higher the quantity supplied.

If, however, there are 30 CDs produced and demand is still at 20, the price will not be pushed up because the supply more than accommodates demand. In fact, after the 20 consumers have been satisfied with their CD purchases, the price of the leftover CDs may drop as CD producers attempt to sell the remaining ten CDs. The lower price will then make the CD more available to people who had previously decided that the opportunity cost of buying the CD at Nam\$20 was too high.

Equilibrium

When supply and demand are equal (i.e. when the supply function and demand function intersect) the product market is said to be at equilibrium. At this point, the allocation of goods is at its most efficient because the amount of goods being supplied is exactly the same as the amount of goods being demanded. Thus, everyone (individuals, firms, or countries) is satisfied with the current economic condition. At the given price, suppliers are selling all the goods that they have produced and consumers are getting all the goods that they are demanding.

Figure 2.8: Equilibrium



As you can see on Figure 2.8, equilibrium occurs at the intersection of the demand and supply curves, which indicates no allocative inefficiency. At this point, the price of the goods will be P and the quantity will be Q . These figures are referred to as equilibrium price and quantity.

It is important to note that market place equilibrium is very difficult to achieve in the real world because prices are constantly changing in relation to fluctuations in demand and supply. As such, market equilibrium can only ever be reached in theory.

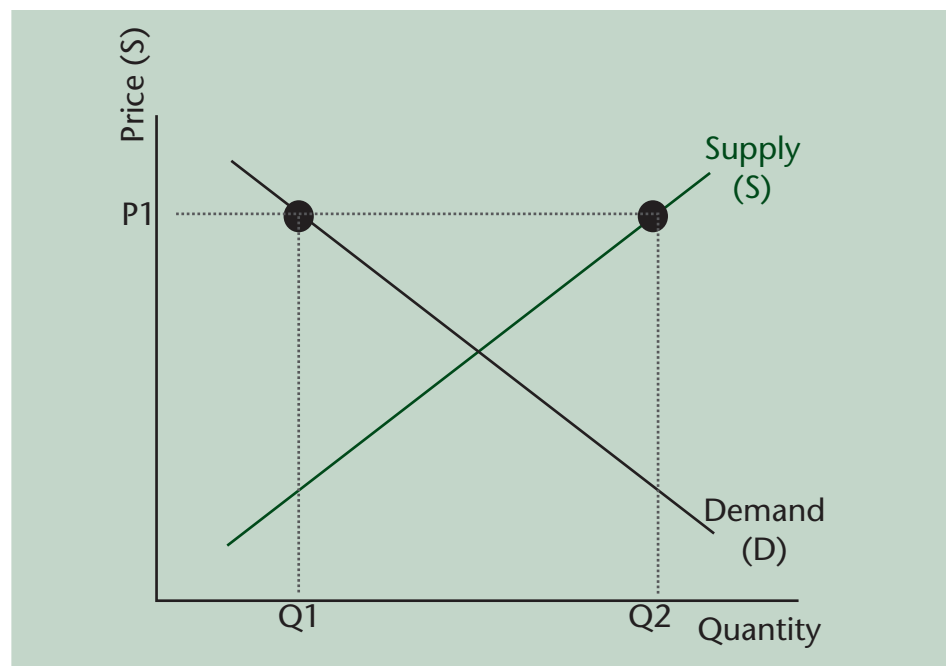
Disequilibrium

Disequilibrium occurs whenever the price or quantity is not equal to P or Q .

(i) Excess supply

If the price is set too high, excess supply will be created within the economy and there will be no allocative efficiency.²

Figure 2.9: Excess supply



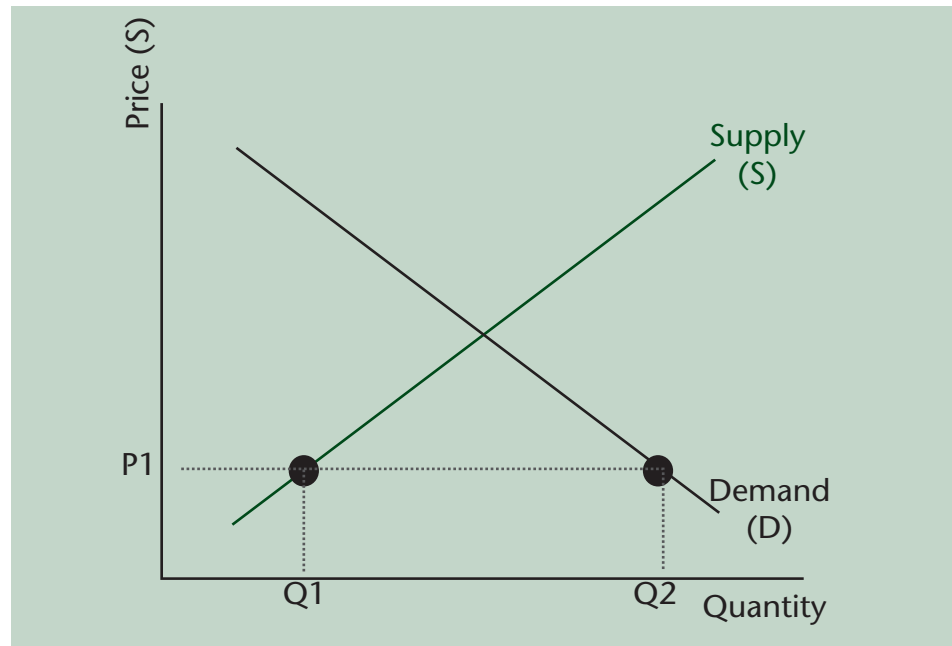
At price P_1 , the quantity of goods that the producers wish to supply is indicated by Q_2 . At P_1 , however, the quantity that the consumers want to consume is at Q_1 , a quantity much less than Q_2 . Because Q_2 is greater than Q_1 , too much is being produced and too little is being consumed. The suppliers are trying to produce more goods, which they hope to sell to increase profits, but those consuming the goods will find the product less attractive and purchase less because the price is too high.

² In economics, 'allocative efficiency' refers to a situation in which the limited resources of a country are allocated in accordance with the wishes of consumers. An allocatively efficient economy produces an "optimal mix" of commodities.

(ii) Excess demand

Excess demand is created when price is set below the equilibrium price. Because the price is so low, too many consumers want the good while producers are not making enough of it.

Figure 2.10: Excess demand



In this situation, at price P_1 , the quantity of goods demanded by consumers at this price is Q_2 . Conversely, the quantity of goods that producers are willing to produce at this price is Q_1 . Thus, there are too few goods being produced to satisfy the wants (demand) of the consumers. However, as consumers have to compete with one another to buy the good at this price, the demand will push the price up, making suppliers want to supply more and bringing the price closer to its equilibrium.

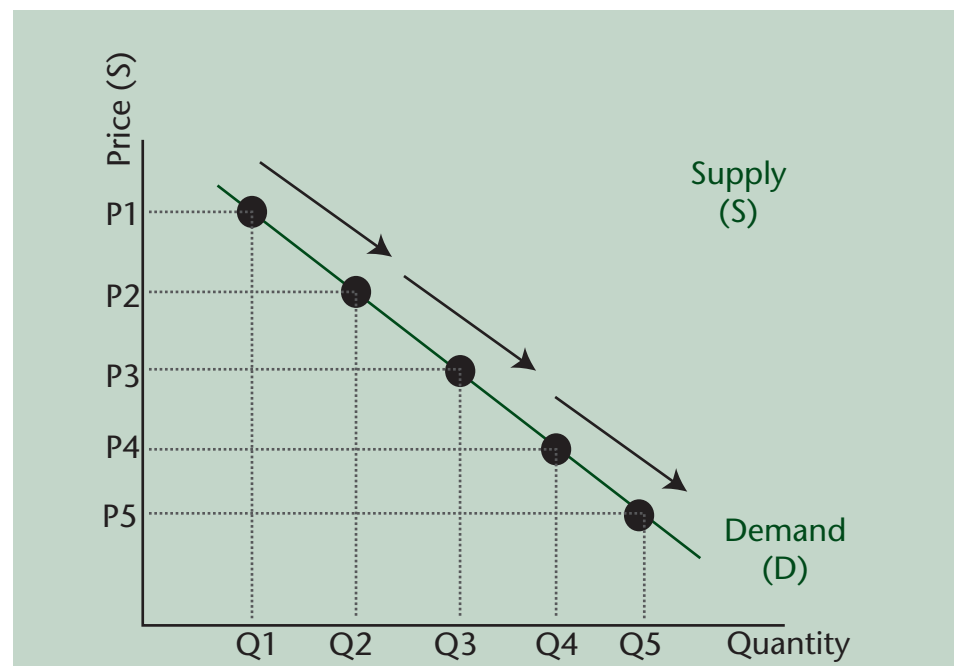
Shifts versus movement

For economics, the “movements” and “shifts” in relation to the supply and demand curves represent very different market phenomena.

(i) Movements

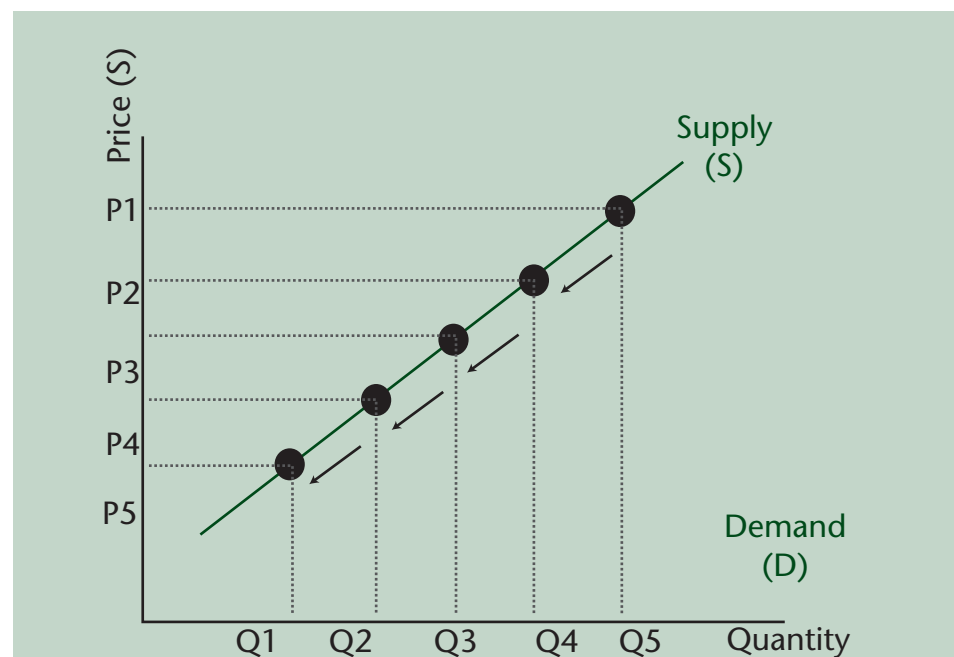
A movement refers to a change along a curve. On the demand curve, a movement denotes a change in both price and quantity demanded from one point to another on the curve. The movement implies that the demand relationship remains consistent. Therefore, a movement along the demand curve will occur when the price of the good changes and the quantity demanded changes in accordance to the original demand relationship. In other words, a movement occurs when a change in the quantity demanded is caused only by a change in price, and vice versa.

Figure 2.11: Movement along the demand curve



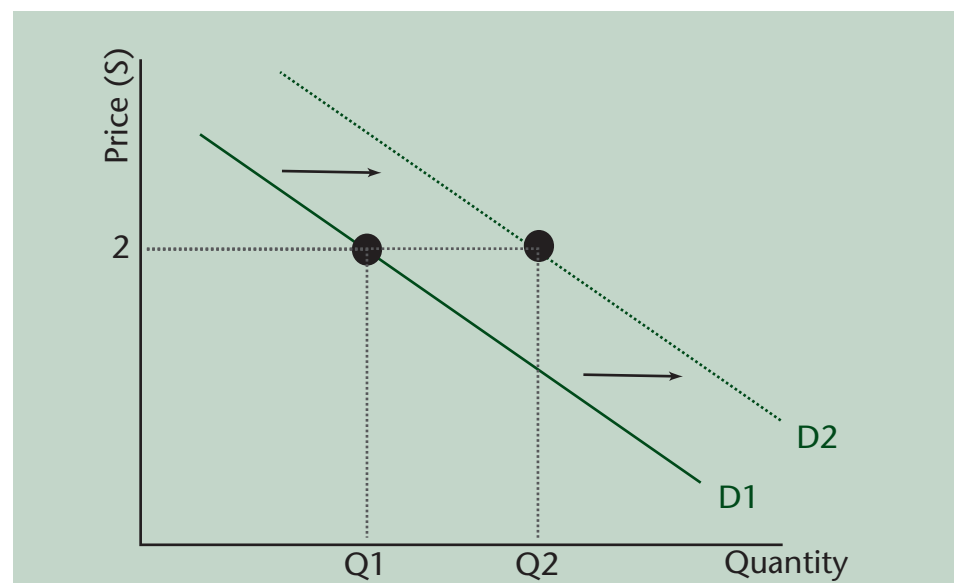
Like a movement along the demand curve, a movement along the supply curve means that the supply relationship remains consistent. Therefore, a movement along the supply curve will occur when the price of the good changes and the quantity supplied changes in accordance to the original supply relationship. In other words, a movement occurs when a change in quantity supplied is caused only by a change in price, and vice versa.

Figure 2.12: Movement along the supply curve



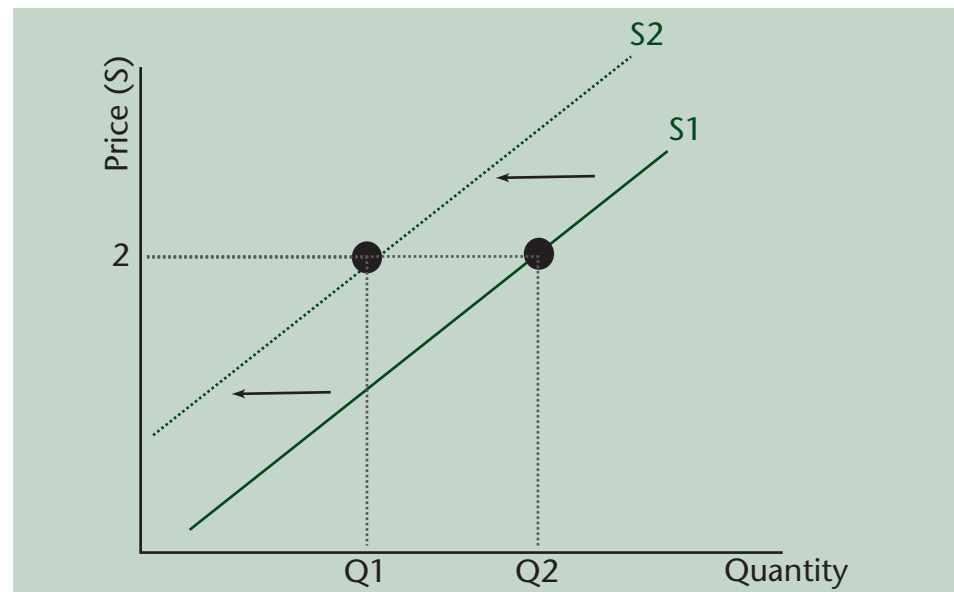
(ii) Shifts

A shift in a demand or supply curve occurs when a good's quantity demanded or supplied changes even though the price remains the same. For instance, if the price for a packet of orange juice was \$2 and the quantity of orange juice demanded increased from Q_1 to Q_2 , then there would be a shift in the demand for orange juice. Shifts in the demand curve imply that the original demand relationship has changed, meaning that quantity demand is affected by a factor other than price. A shift in the demand relationship would occur if, for instance, orange juice suddenly became the only type of juice available for consumption.

Figure 2.13: Shift in demand

Conversely, if the price of a packet of orange juice was \$2 and the quantity supplied decreased from Q_1 to Q_2 , then there would be a shift in the supply of orange juice. Like a shift in the demand curve, a shift in the supply curve implies that the original supply curve has changed, meaning that the quantity supplied is affected by a factor other than price. A shift in the supply curve would occur if, for instance, a natural disaster caused a mass shortage of oranges; orange juice processors would be forced to supply less juice for the same price.

Figure 2.14: Shift in supply



Elasticity of demand and supply

The law of demand states that if prices increase, quantity of labour demanded decrease while on the other hand, the law of supply states that if prices decrease, quantity supplied decreases. However, it is not all the cases that quantity supplied and demanded will respond to prices. This leads to the economic concepts of elasticity of demand and supply. Elasticity measures the responsiveness of quantity demanded and supplied of labour to price changes. Elasticity is measured in per cent changes.

Elastic demand for labour

If per cent change in quantity of labour demanded is greater than the per cent change in wages, demand is said to be elastic. This means that a small increase in wages leads to a higher quantity demanded, or quantity of labour demanded is very responsive to wage changes.

Inelastic demand for labour

When the per cent change in labour demand is smaller than the per cent change in wages, demand is said to be inelastic. In other words, demand is not very responsive to wage changes. This situation has great implications on levels of employment and a unions bargaining power. In the case of inelastic demand, employment levels tend to remain constant even if unions negotiate for a higher salary for workers. In addition, inelastic demand occurs when labour is indispensable and irreplaceable, the employer has to produce a certain number of units at all cost; and capital and other non-labour factors remain fixed.

Elastic supply

When the per cent change in quantity supplied is greater than per cent change in wages, supply is said to be elastic. This means that the number

of labour units supplied is very responsive to changes in wage. The effect of elastic supply is competitive wages.

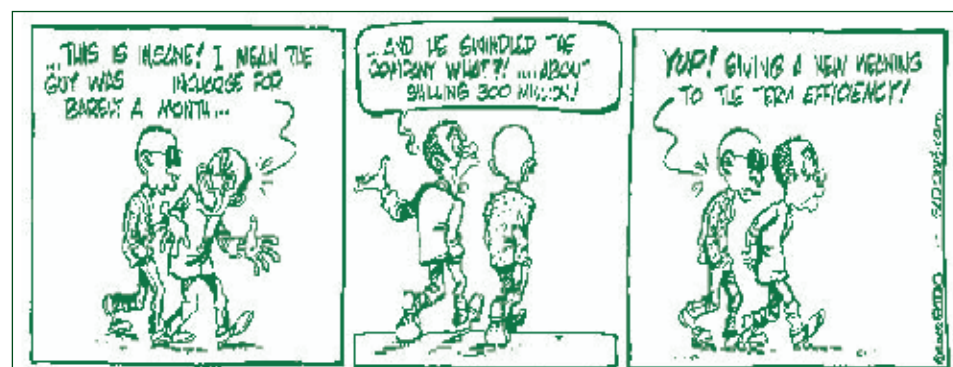
Inelastic supply

When the per cent change in quantity supplied is less than per cent change in wages, supply is inelastic. This means that the number of labour units supplied is not very responsive to changes in wage rates. Causes of inelastic supply include market discrimination, a closed labour market, labour immobility and lack of skills training.

A number of factors determine the elasticity:

- **Substitutes:** The more substitutes, the higher the elasticity, as people can easily switch from one good to another if a minor price change is made
- **Per cent of income:** The higher the per cent that the product's price is of the consumer's income, the higher the elasticity, as people will be careful with purchasing the good because of its cost
- **Necessity:** The more necessary a good is, the lower the elasticity, as people will buy it no matter the price, such as basic food
- **Time:** The longer a price change holds, the higher the elasticity, as more and more people will stop demanding the good (i.e. if you go to the supermarket and find that pineapples have doubled in price, you will buy them because you need them this time, but next time you will not, unless the price drops again)
- **Breadth of definition:** The broader the definition, the lower the elasticity. For example, Farmers Choice sausages will have a relatively high elasticity, whereas food in general will have an extremely low elasticity

(b) Theory of firm



Daily Nation, 24 March 2003, <http://www.gadonet.com>

The theory of firm consists of a number of economic theories that describe the nature of the firm, company, or corporation, including its existence, its behaviour, and its relationship with the market.

In simplified terms, the theory of firm aims to answer these questions:

- Existence—why firms emerge, why not all transactions in the economy are mediated over the market?
- Boundaries—why the boundary between firms and the market is located exactly there? Which transactions are performed internally and which are negotiated on the market?
- Organization—why firms are structured in such specific way? What is the interplay of formal and informal relationships?

Despite looking simple, these questions are not answered by the established economic theory, which usually views firms as given, and treats them as black boxes without any internal structure.

Different types of market structures

Consumers buy goods and services from sellers in five different market structures, known as perfect competition, monopolistic competition, oligopoly, monopoly and monopsony. The nature and degree of competition varies across the five market structures.

Characteristics such as the number of buyers and sellers, the degree of product homogeneity, entry and exit conditions, the quality of information available to both buyers and sellers, and the extent of government intervention help distinguish the five market structures. Let us examine the nature and degree of market competition in the five market structures.

Perfect competition

Perfect competition occurs when there are many buyers and sellers, the product is homogeneous, entry and exit are easy, buyers and sellers have perfect information, and there is no government intervention. Since the product is homogeneous, consumers buy from sellers offering the lowest price. And since there are many buyers and sellers, the equilibrium price is determined by market demand and market supply.

Assumptions behind a perfectly competitive market:

- Many suppliers, each with an insignificant share of the market. This means that each firm is too small relative to the overall market to affect price via a change in its own supply. Each individual firm is assumed to be a price taker.
- An identical output produced by each firm. In other words, the market supplies homogeneous or standardized products that are perfect substitutes for each other. Consumers perceive the products to be identical.
- Consumers have perfect information about the prices all sellers in the market charge. Therefore, if some firms decide to charge a price higher than the ruling market price, there will be a large substitution effect away from this firm.

- All firms (industry participants and new entrants) have equal access to resources (technology, other factor inputs) and improvements in production technologies achieved by one firm can spill over to all the other suppliers in the market.
- There are no barriers to entry and exit of firms in the long run. This means that the market is open to competition from new suppliers. This affects the long run profits made by each firm in the industry. The long run equilibrium for a perfectly competitive market occurs when the marginal firm makes normal profit only in the long term.
- No externalities in production and consumption, such that there is no divergence between private and social costs and benefits.³

From an economic perspective, perfectly competitive markets offer superior economic performance. Why? First, perfectly competitive markets efficiently allocate resources since these firms charge a price equal to marginal cost. Second, in the long run, the price is driven to the lowest possible average cost of production given existing technology, so that the firm earns a normal profit. Third, perfectly competitive firms are technically efficient in the long run, since competition forces them to become efficient.

Unfortunately, relatively few markets are perfectly competitive in the real world. More so, in the industrialized countries where there is government intervention, many markets even in agricultural commodities such as maize, wheat and beans are not perfectly competitive.

Monopolistic competition

Monopolistic competition occurs in a market where there are many buyers and sellers, the products are differentiated, and entry and exit are relatively easy. Even though there are many buyers and sellers, the individual firm in this market can set the price since products are differentiated.

In a monopolistic competitive market, firms may engage in both price and product competition. A firm in this market may be able to earn a short run economic profit by engaging in a product differentiation strategy by advertising its product, by introducing a redesigned product with new or different characteristics, by locating near customers, or by offering superior pre-sale or post-sale customer services. However, as noted above, the firm's ability to increase price is constrained by the availability of many good consumer substitutes.

A monopolistic competitive market has less attractive economic performance than perfect competition. Monopolistic competitive markets tend to under-employ economic resources, since firms charge prices that exceed marginal cost. Individual firms tend to operate plant sizes that are smaller than is technically efficient. On the other hand, this market offers consumers product variety that is non-existent in perfect competition.

³ In economics, an externality is an impact on any party not directly involved in an economic decision. An externality occurs when an economic activity causes external costs or external benefits to third party stakeholders who cannot directly affect an economic transaction.

Monopolistic competitive markets are relatively common. In larger metropolitan areas, many different retail markets have many buyers and sellers, differentiated goods or services, and relatively easy entry and exit. For example, the fast food market in larger metropolitan areas is a good example of monopolistic competition. The large number of clothing and textile shops in major towns in South Africa is a good example of a monopolistic competitive market.

Oligopoly

Oligopoly occurs in a market where there are few sellers and many buyers, the products are either homogeneous or differentiated, and entry is relatively difficult. Since there are relatively few sellers in this market, the firms are strategically interdependent. If one firm decides to lower its price, the firm is likely to take customers from rivals. This forces rivals to react to the price decrease. If rivals quickly match the price decrease, then all firms will earn lower economic profits. A profit-maximizing firm in this market must, therefore, consider the likely reactions of rivals to each strategy in order to identify the profit-maximizing strategy.

In oligopolistic markets where firms offer homogeneous products, consumers will buy from the seller offering the lowest price. Price competition is, therefore, the primary means of competition, and firms therefore tend to focus on being efficient in order to offer the lowest price possible to consumers. In many cases, the quest for efficiency may require larger and fewer firms, since technology may require one firm to produce a significant per cent of what consumers wish to buy.

When compared to perfectly competitive markets, oligopolistic markets generally have less favourable economic performance. Oligopolistic firms tend to under-employ resources, produce less of the good or service, and charge higher prices. On the other hand, some oligopolistic markets offer consumers some product variety.

Oligopolies are common in many countries in Africa. Many manufacturing industries are oligopolistic. Some examples include mobile phone service providers, motor vehicle assembly, beverages and beer production, and production of household appliances.

Cartels: An example of an oligopoly

A cartel is a group of collaborating firms that coordinate output, pricing and other policies so as to minimize competition. Such actions lead them to acquiring monopoly power. The aim of a cartel is to produce small quantities of a commodity (a key action) while the prices are raised above the competitive firms. They are sometimes called “collusive oligopoly” because the firms bargain amongst themselves on how much each firm should produce. A cartel is not easily sustainable since players have a large incentive to cheat and gain higher profits rather than respecting the collusive agreement. Examples include DeBeers, which specializes in diamond mining, and the Organization of Petroleum Exporting Countries (OPEC). Within OPEC, production quotas are set and OPEC monitors imports, exports and prices of oil.

Monopoly

Monopoly occurs when there is one seller offering a unique product, and entry is very difficult. Monopolies are often protected by barriers to entry, which make entry difficult. Some of the most important barriers are government actions. For example, government often grants an electricity utility an exclusive franchise to provide electricity services in a community, but then regulates the rates the utility can charge customers. Without barriers to entry, most profitable monopolies would probably be relatively short lived.

When compared to perfect competition, monopolistic markets have inferior economic performance. The monopolistic firm under-employs economic resources, may not be as efficient as technology permits, and may continue to earn economic profits in the long run.

Due to extensive legislation, monopolies are relatively rare in industrialized countries but quite common in Africa. Many utilities have monopolies in communities due to exclusive government franchises. In smaller communities, there may be only one seller in many retail markets due to a small customer base.

Monopsony

A monopsony is a market where there is a single buyer of a commodity but many sellers. In other words, the demand comes from one source. In the case of labour markets, monopsony means that there is only one buyer of labour; that is, one employer who has the market power and therefore sets the wage. For example, if workers in an isolated company town are created by and dominated by one employer, that employer is a monopsonist. In the monopsony case, the employer can offer wages below market rates.

In the case of trade, large importing countries are said to have “monopsony power.” A monopsonist raises its own welfare or utility by restricting the

demand for the product and thereby forcing the sellers to lower their price to the monopsonist. By buying fewer units at a lower price, the monopsonist becomes better-off. For example, when a large importing country places a tariff on imports, the country's demand for that product on the world markets falls, which in turn lowers the world market price.

Table 2.2: Summary of market structures

Market structure	Number of firms	Product type	Entry conditions	Profitability
Perfect competition	Many	Homogeneous	Free	Normal
Monopolistic	Many	Differentiated	Free	Normal
Oligopoly	Few	Usually differentiated	Restricted	Generally above normal
Monopoly	One	Either	Strictly restricted	Super-normal
Monopsony	One buyer many sellers	Homogeneous	Free	Above normal

2.3 Factors of production and factor payments



Daily Nation, 22 August 2003, <http://www.gadonet.com>

(a) Factors of production

In economics, factors of production are the resources employed to produce goods and services. Here, the quantity of output is derived from a given combination of factor inputs employed. Classification of factors

can include such broad aggregates as labour, land, capital, the overall state of technology, and entrepreneurship. The number and definition of factors can vary depending on theoretical purpose, empirical emphasis, or school of economics.

Labour: Labour is the mental and physical efforts of humans (excluding entrepreneurial organization) used for the production of goods and services. Labour includes both the physical effort of factory workers and farmhands often associated with labour, as well as the mental effort of executives and supervisors.

Capital: Capital is the manufactured, artificial, or synthetic goods used in the production of other goods, including machinery, equipment, tools, buildings, and vehicles. Capital is the produced factor of production. This factor must be produced using other factors of production, which means that society is often faced with the choice between producing consumption goods that satisfy wants and needs or capital goods that are used for future production.

Without capital, labour would do all production “by hand.” The key role of capital in the production process is to make labour more productive. While a convoy of construction workers might be able to fabricate a four-bedroom house with nothing but bare hands, an assortment of hammers, saws, and other tools is bound to make their work easier and more productive.

Land: Land is the naturally occurring materials of the planet that are used for the production of goods and services, including the land itself; the minerals and nutrients in the ground; the water, wildlife, and vegetation on the surface; and the air above. The natural resources and materials of the land become the goods produced. Without these materials of the land, there is no production. Production is, in fact, the basic process of transforming naturally occurring materials that provide little satisfaction in their natural state to goods and services that provide more satisfaction.

Entrepreneurship: Entrepreneurship is the special sort of human effort that takes on the risk of bringing labour, capital, and land together to produce goods. Entrepreneurship is the factor that organizes the other three. Without someone to organize production, the other three factors do NOT produce. A key component of entrepreneurship is risk. This resource takes the risk of organizing production BEFORE anything is produced and with no guarantee that production will be successful.

Technology: Technology is a broad concept that deals with the usage and knowledge of tools and crafts, and how it affects our ability to control and adapt to the environment. Technology is a consequence of science and engineering. It also refers to material objects of use to humanity, such as machines, hardware or utensils. It can also encompass broader themes, including systems, methods of organization, and techniques. The recent trends of technological development brought about by information technology have extended the list of the factors of production. In the context of information and computer technologies, many believe that

technology (such as computer programmes) and intellectual property rights are now part of the factors of production.

(b) Factor payments

The general term for the monetary payments to factors of production is factor payments. However, the specific factor payment depends on the specific factor exchanged: the factor payment of labour is wage, for capital is interest, for land is rent, and for entrepreneurship is profit. Such factor payments are what entice owners to allocate their resources for productive use.

Wage: This is a payment to the owner of labour in exchange for the productive service of labour. While wages are typically monetary payments, and result in payslips, they invariably involve non-monetary components. Common examples are employer contributions for health insurance, retirement programmes, and other fringe benefits. Moreover, the psychological rewards provided by the job itself are important factor payments.

Interest: This is a payment to the owner of capital in exchange for the productive services of capital. Interest payments are something of a round-about payment for capital services, based on the recognition that capital goods are generally purchased with borrowed funds. Such borrowing is profitable so long as the interest on the loan is matched by the productivity of the capital acquired.

Rent: This is a payment to the owner of land in exchange for the productive services of land. Because land is a diverse resource category, so too is this notion of rent. It includes payments for the use of the land itself as well as the assorted resources extracted from the land.

Profit: This is a payment to the owner of entrepreneurship in exchange for the productive services of entrepreneurship. Profit falls into one of two categories—normal profit, which is an opportunity cost based on the next best use of entrepreneurship, and economic profit, which is the excess of total revenue over total cost.

Royalty: This is the usage-based payment made by one party (the “licensee”) to another (the “licensor”) for ongoing use of an asset, sometimes an intellectual property right. Royalties can be determined as a per cent of gross or net sales derived from use of the asset or a fixed price per unit sold.

Factor demand

Factor demand is the demand side of the factor market, capturing the relation between the factor price and the quantity demanded of a factor. In general, a lower price induces an increase in the quantity demanded, while a higher price has the opposite effect.

Factor demand is commonly represented by a factor demand curve, which graphically indicates the quantity of a factor that is demanded at

alternative factor prices. Figure 2.15 shows a typical factor demand curve. This particular curve is the demand for labour. The number of workers is measured on the horizontal axis and the wage paid per worker is measured on the vertical axis. This factor demand curve indicates that employers are willing to hire 4 workers at \$35 each, 5 workers at \$25 each, and 6 workers at \$15 each. The wage declines with increase in the number of workers employed because extra workers contribute less and less to total production and to total revenue.

Figure 2.15: Factor demand curve

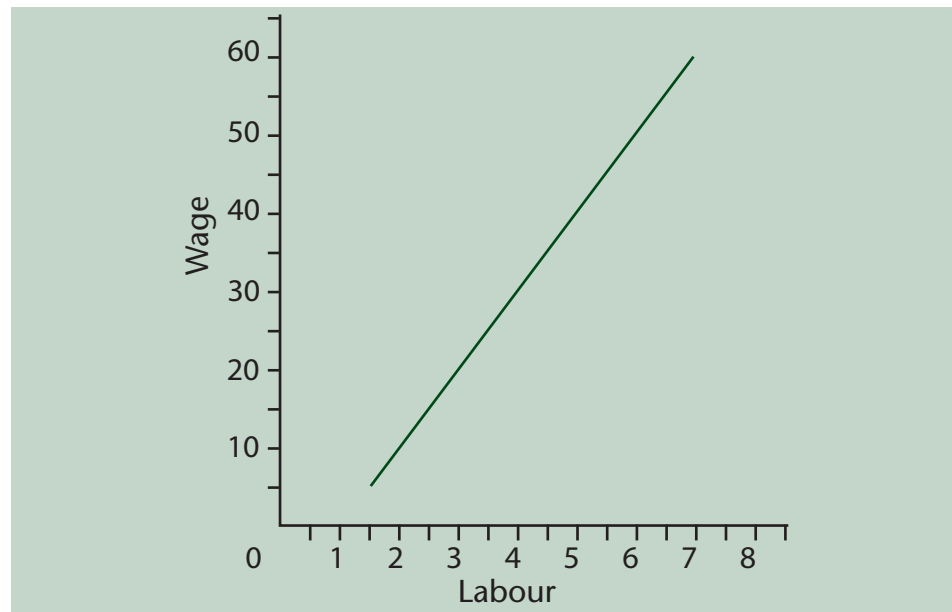


Factor supply

Factor supply is the supply side of the factor market, capturing the relation between the factor price and the quantity supplied of a factor. In general, a higher price induces an increase in the quantity supplied, while a lower price has the opposite effect.

Factor supply works much like the market supply of any good or service. Sellers, or factor owners, are enticed to offer a larger quantity for sale at a higher price. However, because the factors supplied are diverse (various types of labour, capital, land, and entrepreneurship), so too are the principles underlying supply.

Figure 2.16: Factor supply curve



Factor supply is commonly represented by a factor supply curve, which graphically indicates the quantity of a factor that is supplied at alternative factor prices. Figure 2.16 shows a typical factor supply curve. The number of workers (labour) is measured on the horizontal axis and the wage paid per worker on the vertical axis. This factor supply curve indicates that a \$10 wage entices 2 workers to supply their services, a \$30 wage entices 4 workers to supply their services, and a \$50 wage entices 6 workers to supply their services. The number of workers willing and able to supply their productive services increases with the wage.



Myth 2: Imports from countries where labour is cheap cause unemployment in the industrialized countries

One of the many problems with this doctrine is that it ignores the question: why are wages low in developing countries and high in the industrialized countries? Wages are basically high in industrialized countries because labour productivity is high—because workers are aided by large amounts of technologically advanced capital equipment. Wage rates are low in poor countries because capital equipment is small and technologically primitive. Wage rates in every country are determined by the productivity of the workers in that country.

Factor mobility

Factor mobility refers to the ease with which factors of production, such as labour, capital, land, and natural resources can be reallocated across sectors within the economy. Different degrees of mobility arise because there are different costs associated with moving factors across industries. There are two main types of factor immobility, occupational and geographical immobility.

(i) Occupational immobility

Occupational immobility occurs when there are barriers to the mobility of factors of production between different industries and occupations. This can lead to people remaining unemployed, or being used in ways that are not economically efficient.

Some capital inputs are occupationally mobile. A computer, for example, can be put to productive use in many different industries. Commercial buildings can be altered to provide a base for many businesses. However, some units of capital are specific to the industry they have been designed for.

Labour as a factor of production often experiences occupational immobility. For example, workers made redundant in the sheet metal industry may possess job-specific skills that are not necessarily transferable to the growing industries in the economy. This implies that there is a mismatch between the skills on offer from the unemployed and those required by employers looking for extra workers. This is also called structural unemployment and is a major reason why there is a core of workers in the industrialized countries who find it difficult to find paid work. Clearly, this leads to a waste of scarce resources and represents market failure, because social welfare is not being maximized.

All factors of production can also experience immobility due to obsolescence. Obsolescence is the state of being which occurs when a person, object, or service is no longer wanted even though it may still be in good working order. Obsolescence frequently happens because a superior replacement has become available, e.g. smaller, faster, lighter or less expensive.

(ii) Geographical immobility

Geographical immobility exists when there are barriers to people moving from one area to another to find work.

There are good reasons why geographical immobility might exist:

- Family and other social ties
- Costs involved in moving home
- Regional variations in house prices
- Differences in the general cost of living between regions

Policies to improve mobility of labour

Labour mobility is best gauged by the lack of impediments to such mobility. Impediments to mobility are easily divided into two distinct classes with one being personal and the other being systemic. Personal impediments include physical location, and physical and mental ability. The systemic impediments include educational opportunities as well as various laws and political contrivances and even barriers and hurdles arising from historical happenstance. Increasing and maintaining a high level of labour mobility allows a more efficient allocation of resources.

To reduce labour immobility the government might:

- Invest in increased provision of training schemes for the unemployed –particularly those workers experiencing structural unemployment.
- Subsidize the provision of industrial training by private sector firms either through grant assistance or through tax relief.
- Raise total spending on education and move towards increased investment in vocational training for students.

To reduce geographical immobility, the government or appointed agencies might introduce reforms to the housing market designed to improve the supply and reduce the cost of rented properties. Another option is to offer specific subsidies for people moving into areas where there are shortages of labour.

The current prevalence of “labour exporting” may also be included as a measure to reduce labour immobility, although most governments would not admit it. Although it may popularly be viewed as “labour migration”, it is no longer a personal initiative but a government effort, which is being promoted to ease unemployment.

2.4 Market failure

The theory of supply and demand usually assumes that markets are perfectly competitive. This implies that there are many buyers and sellers in the market and none of them have the capacity to significantly influence prices of goods and services. In many real-life transactions, the assumption fails because some individual buyers or sellers or groups of buyers or sellers have the ability to influence prices. Quite often, a sophisticated analysis is required to understand the demand-supply equation of a good. However, the theory works well in simple situations.

In microeconomics, the term “market failure” does not mean that a given market has ceased functioning. Instead, market failure is a situation in which a given market does not efficiently organize production or allocate goods and services to consumers. Economists normally apply the term to situations where the inefficiency is particularly dramatic, or when it is suggested that non-market institutions would provide a more desirable result. On the other hand, in a political context, stakeholders may use the term market failure to refer to situations where market forces do not serve public interest.

There are four main types or causes of market failure:

- (a) **Monopolies** or other cases of abuse of market power where a single buyer or seller can exert significant influence over prices or output.

The classical economic case against monopoly is that:

- Price is higher and output is lower under monopoly than in a competitive market.
- This causes a net economic welfare loss of both consumer and producer surplus.
- Price is greater than marginal cost, leading to allocative inefficiency and a Pareto sub-optimal equilibrium⁴.
- Rent seeking behaviour by the monopolist might add to the standard costs of monopoly.⁵ This includes high (possibly excessive) amounts of spending on persuasive advertising and marketing.
- Libenstein's X-inefficiency may also result if the monopolist allows cost efficiency to drop.⁶ An upward drift in costs, because of lack of effective competition in the market place, can lead to consumers facing higher prices and a reduction in their real standard of living.

Abuse of market power by monopolies can be reduced by using anti-trust regulations.

- (b) **Externalities** occur in cases where the market does not take into account the impact of an economic activity on outsiders. There are positive externalities and negative externalities. Positive externalities occur in cases such as when a television programme on family health improves the public's health. Negative externalities occur in cases such as when a company's production processes pollutes air or waterways.

Negative externalities can be reduced by using government regulations, taxes, or subsidies, or by using property rights to force companies and individuals to take the impacts of their economic activity into account.

- (c) **Public goods** are not provided by the free market because of their two main characteristics:

⁴ An economic system that is Pareto inefficient implies that a certain change in allocation of goods (for example) may result in some individuals being made "better off" with no individual being made worse off.

⁵ In economics, rent seeking occurs when an individual, organization or firm seeks to make money by manipulating the economic and/or legal environment rather than by trade and production of wealth.

⁶ In economics, x-efficiency is the effectiveness with which a given set of inputs are used to produce outputs. If a firm is producing the maximum output it can, given the resources it employs, such as men and machinery, and the best technology available, it is said to be x-efficient.

- Non-excludability, where it is not possible to provide a good or service to one person without it being available for others to enjoy, and
- Non-rivalry, where the consumption of a good or service by one person will not prevent others from enjoying it.

Examples of public goods include street lighting, lighthouse protection, police services, air defence systems, roads and motorways, terrestrial television, flood defence systems, and public parks and beaches.

Because of their nature, the private sector is unlikely to be willing and able to provide public goods. The government, therefore, provides them for collective consumption and finances them through general taxation.

- (d) **Merit goods** are those goods and services that the government feels that people left to themselves will under-consume and which, therefore, ought to be subsidized or provided free at the point of use.

Both the public and private sector of the economy can provide merit goods and services. Consumption of merit goods is thought to generate positive externality effects where the social benefit from consumption exceeds the private benefit. Examples of merit goods include health services, education, work training, public libraries, citizen's advice, and inoculations.

Market failure has become an increasingly important topic for trade unions. This is because there is a clear economic case for government intervention in markets where some form of market failure is taking place. Government can justify this by saying that intervention is in the public interest. Basically, market failure occurs when markets do not bring about economic efficiency.



Activity: Microeconomics problem

A father goes to the pharmacy late at night for medicine for a sick child. There are many liquid medicines for cold, all of which have almost exactly the same ingredients. Yet, medicines with brand names that the man recognizes from TV commercials sell for more than the unadvertized versions.

Explain, in economic terms, this perplexing situation to the father.



Microeconomics Quiz

1. According to the basic model of competition in a market, firms seek to maximize profits.
 - ☐ True
 - ☐ False
2. Economics cannot claim to be a science since the subject cannot make use of controlled experiments to test a theory.
 - ☐ True
 - ☐ False
3. In economics, all economic agents, be they consumers, businesses or government must make choice because:
 - A. They must act rationally
 - B. Of the law of diminishing returns
 - C. None of the above
 - D. Of resource scarcity
4. Of consumers acting rationally, we mean that
 - A. They seek to weigh the costs and benefits of each choice they make
 - B. They will not take jobs that pay low wages
 - C. They will always buy the products in the market that are cheapest
 - D. They save a proportion of their monthly income rather than spend it all
5. Which of the following is not a factor of production as the term is used by economists?
 - A. Workers in a supermarket
 - B. Cash in bank account
 - C. Aircraft owned by Kenya Airways
 - D. Farmland
6. An economy has a given stock of factor inputs of labour, land and capital. The production possibilities for two products, steel and wine, are shown in the table below:

Output of Steel (tonnes of steel per year)	Output of Wine (Thousands of bottles per year)
0	1500
50	1480
100	1450
150	1400
200	1300
250	1175
300	1000
350	750
400	450
450	100
500	0

What is the opportunity cost of increasing output of steel from 200 to 250 units?

Answer: -----

7. A period of high unemployment in an economy corresponds to:

- A. Points that lie on the production possibility curve
- B. Points that lie within the production possibility curve
- C. None of the above
- D. Points that lie outside the production possibility curve

8. A combination of goods and services that lie within the production possibility curve show an inefficient allocation of resources:

- ☐ True
- ☐ False

9. A fall in the size of the available labour supply, other factors remaining constant, will cause an outward shift of a production possibility curve:

- ☐ True
- ☐ False

10. Economics as a subject is primarily concerned with the study of:

- A. Allocating scarce resources to satisfy competing and unlimited wants
- B. Determining how the government should allocate resources
- C. How new wants and economic resources are produced by businesses
- D. How to make more effective use of resources by reducing wants

Answers: (1) True; (2) False (3) D; (4) A; (5) B; (6) 1125; (7) B (8) True; (9) False (10) A

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Unit 3: Key principles of macroeconomics

Topics

- Background to macroeconomics
- Concept of economic cycle and key macroeconomic indicators
- Measurement of economic performance
- Monetary policy: Money supply and money demand
- Fiscal policy
- Economic growth and productivity
- Open economy: International trade and finance

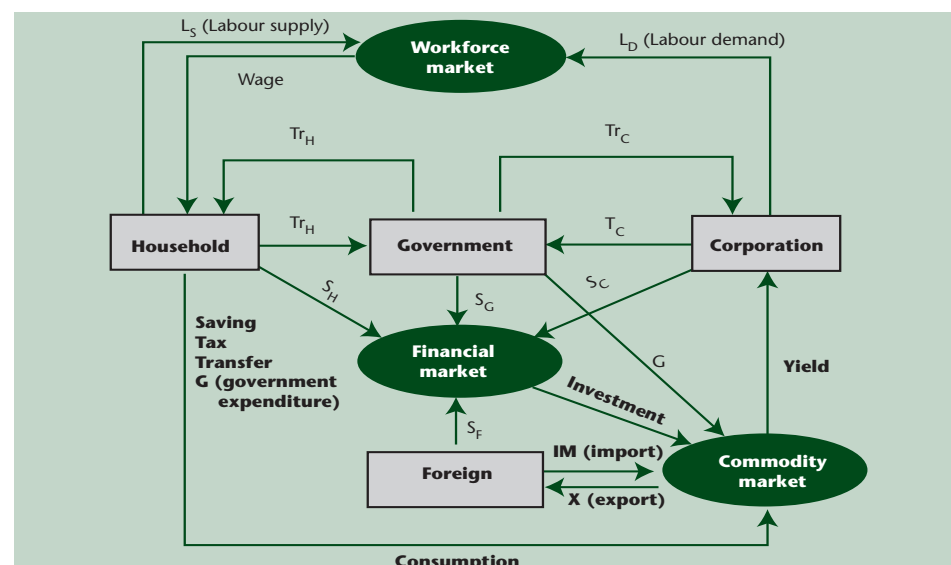
3.1 Background to macroeconomics

Whether we like it or not, economic themes tend to dominate the news. A day seldom passes that we do not hear about unemployment, inflation, economic growth, stock markets, interest rates, or foreign exchange rates. We hear and read so much about these phenomena because, directly or indirectly, they affect our well-being. It is perhaps mostly for this reason that macroeconomics, the study of these economy-wide phenomena, is so exciting.

Macroeconomics is a branch of economics that deals with the performance, structure, and behaviour of a national or regional economy as a whole. Macroeconomists develop models that explain the relationship between such factors as national income, output, consumption, unemployment, inflation, savings, investment, international trade and international finance.

Macroeconomic models and their forecasts are used by both governments and large corporations to assist in the development and evaluation of economic policy and business strategy.

Figure 3.1: A snapshot of macroeconomic analysis



“There’s no such thing as a free lunch.”

From a custom in San Francisco saloons in the 19th century, often attributed to sci-fi writer Robert Heinlein from his 1966 novel, *The Moon is a Free Mistress*, this phrase was picked up and popularized by Friedman in economics classrooms. He highlighted the underlying economic principle that even when something looks as if it’s free, it’s usually not. Whether the supplier is a friend, a business, or the government, we ultimately pay for what we get.

Milton Friedman, American Nobel Laureate economist and public intellectual, 1912–2006.

3.2 Concept of economic cycle and key macroeconomic indicators

(a) Six key macroeconomic variables

You can get a good idea of the pulse of recent economic activity by simply looking at six key economic variables. Together, they summarize the state of the macroeconomy. If you want to be able to say more than “the economy is good,” or “the economy is not so good,” you need to understand and be able to analyse these six variables. These six key indicators are:

- Real Gross Domestic Product
- Unemployment rate
- Inflation rate
- Interest rate
- Level of the stock market
- Exchange rate

Figures 3.2 and 3.3 show a sample of the kinds of economic data that economists, politicians, and others including investors in the stock and bond markets use to assess the course of the economy. The sheer number of statistics is confusing at first glance, but all the statistics are either: (i) direct measures of the six key economic indicators that together tell most of the story, or; (ii) primarily useful as partial forecasts of or as factors that help determine the six key indicators of economic activity.

(i) Real GDP

The first key indicator is the level of Real Gross Domestic Product, called “*real GDP*” or often just “*GDP*” for short.

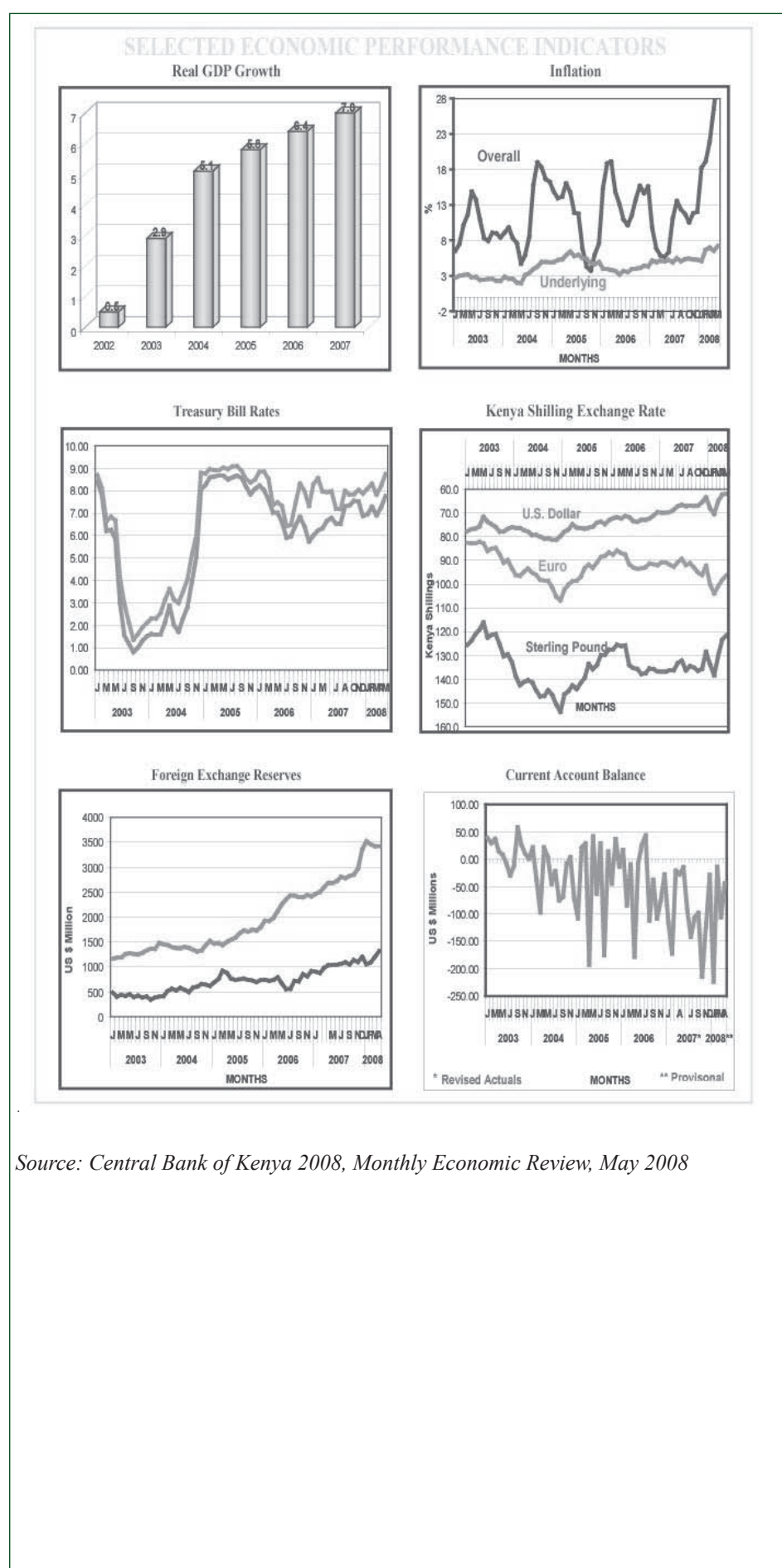
“*Real*” means that this measure corrects for changes in the overall level of prices. For example, if total spending doubles because the average level of prices doubles but the total flow of commodities does not change, then real GDP does not change.

“*Gross*” means that this measure includes the replacement of worn out and obsolete equipment and structures as well as completely new investment.

“*Domestic*” means that this measure counts economic activity that happens in the country, whether or not the workers are legal residents and whether or not the factories are owned by national companies.

“*Product*” means that real GDP represents the production of final goods and services.

Figure 3.2: Selected monthly economic indicators in Kenya



Source: Central Bank of Kenya 2008, *Monthly Economic Review*, May 2008

Distinguish between real and nominal variables

Table 3.1: Selected monthly economic indicators in Kenya, 2007-2008

Indicator	2007					2008				
	Mar	Apr	May	Jun	Dec	Feb	Mar	Apr	May	
1. Inflation (%)										
CPI	225.30	222.61	221.83	224.93	239.81	266.37	274.49	281.88	291.79	
Overall inflation										
12-month overall inflation	5.87	5.66	6.33	11.10	12.03	19.13	21.83	26.63	31.54	
Average annual overall inflation	11.73	10.92	10.33	10.35	9.76	11.59	12.98	14.79	16.93	
Underlying inflation*										
12-month underlying inflation	5.13	5.03	5.22	4.90	5.25	6.64	6.98	6.54	7.24	
Average annual underlying inflation	4.17	4.29	4.46	4.56	5.18	5.32	5.48	5.60	5.78	
2. Interest rates (%)										
91-day Treasury bill interest rate	6.32	6.65	6.77	6.53	6.87	7.28	8.90	7.25		
Overdraft interest rate	13.95	13.58	13.35	13.20	12.96	13.26	13.48	13.46		
3. Stock market										
Nairobi Stock Exchange Price Index	5133.67	5199.44	5001.77	5146.73	5444.83	5072.41	4843.17	5336.03		
Turnover (%)	1.10	0.72	1.00	1.20	0.97	1.33	1.21	1.21		
4. Balance of Payments (US\$ m)										
Overall balance	92.97	101.34	(54.33)	44.56	387.78	(36.10)	(36.10)	(27.71)		
Current account	(14.95)	(16.669)	(0.06)	(93.04)	(39.78)	(13.29)	(106.26)	843.85)		
Trade balance	(318.99)	(233.91)	(389.61)	8407.44)	(307.56)	(364.90)	(401.78)	(411.19)		
Capital and financial account	107.92	118.00	(54.26)	140.60	427.56	(43.40)	70.16	16.75		
5. Public debt (US\$ bn)										
Domestic	11.25	11.57	12.10	12.04	13.48	12.47	13.84			
As % of GDP	5.64	5.72	5.84	6.08	6.99	6.30	7.08			
External	23.97	21.89	21.66	22.14	22.54	21.92	22.22			
As % of GDP	5.62	6.15	6.27	5.96	6.49	6.17	6.76			
6. Average exchange rate										
Ksh/US\$	69.29	68.58	67.19	66.57	63.30	70.50	64.92	62.26	61.90	
Ksh/Pound sterling	137.91	136.40	133.31	132.25	126.45	138.08	130.08	123.37	121.62	
Ksh/100 Yen	59.08	57.73	55.65	54.27	56.52	65.80	64.04	60.83	59.38	
Ksh/Euro	97.77	92.68	90.82	59.33	92.24	103.96	100.79	96.08	96.32	

* Overall inflation excluding food, energy and transport and communications.

Source: Central Bank of Kenya (2008)



Economic variables are either “**real**”—that is, they have been adjusted for changes in the price level—or “**nominal**”—that is, they have not been adjusted for changes in the price level.

Distinguish between “gross” and “net”

“**Gross**” means that this measure includes the replacement of worn out and obsolete equipment and structures as well as completely new investment (“**Gross**” measures contrast with “**net**” measures, which include only investments that add to the capital stock. “**Net**” measures are better than gross measures, but the information needed to construct them is not reliable).

In simple terms, real GDP is a measure of value of goods and services in a given country within one year.



Question and answer

Question:

Suppose you earn New Ghana Cedis 20,000 in 2007 and New Ghana Cedis 22,000 in 2008. By how much has your nominal income increased? Suppose inflation was 10 per cent for that time period. What would your real income be?

With inflation at 10 per cent, your real income has remained the same since prices are 10 per cent higher.

Your nominal income has increased by $\text{C}\text{\$}2,000/\text{C}\text{\$}20,000 = 10$ per cent.

Answer:

(ii) Unemployment rate

The second key variable is the unemployment rate. The unemployed are people who want to work and who are actively looking for jobs, but who have not yet found one (or have not yet found one that they find attractive enough to take rather than continue to look for a better job). The unemployment rate is equal to the number of unemployed people divided by the total labour force, which is just the sum of the number of unemployed people and the number of people who have jobs.

Most people consider unemployment to be a bad thing, and it usually is. Yet, it is important to notice that an economy with no unemployment at all would probably be a badly-working economy. Just as an economy needs inventories of goods—goods in transit, goods in process, goods in warehouses and sitting on store shelves—in order to function smoothly, it needs “inventories” of jobs-looking-for-workers (“vacancies”) and workers looking for jobs (“the unemployed”). An economy in which each business grabbed the first person who walked through the door to fill a newly open job and in which each worker took the first job offered would be

a less productive economy. Workers should be somewhat choosy about what jobs they take. They should decline jobs when they think that “this job pays too little,” or “this job would be too unpleasant.”



Daily Nation 27 November - 2001, <http://www.gadonet.com>

Likewise, employers should be choosy about which workers they hire. Such frictional unemployment is an inevitable part of the process that makes good matches between workers and firms—matches that pair qualified workers with jobs that use their qualifications.

Similarly, when unemployment rate is high, the market economy is not functioning well. The unemployment rate is the best indicator of how well the economy is doing relative to its productive potential.

(iii) Inflation rate

Zimbabwe inflation rockets higher



The rate of inflation in Zimbabwe jumped to just over 11,250,000% in June, official figures show.

"It gained 9,035,045.5 percentage points from the May rate of 2,233,713.4%," said state media quoting the Central Statistical Office (CSO).

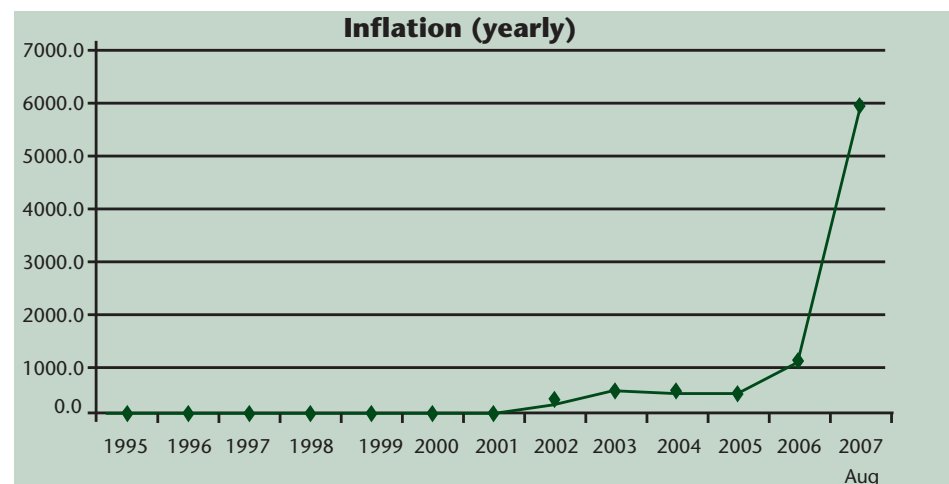
However, experts believe the actual rate of inflation may be much higher

Story from BBC News <http://news.bbc.co.uk/go/pr/fr/-/2/hi/business/7569894.stm>
Published: 19 August 2008

A third key economic indicator is the inflation rate, a measure of how fast the overall price level is rising. If the inflation rate this year is 5 per cent, that means that in general, goods and services cost 5 per cent more this year than they cost last year in money terms. A very high inflation rate—say more than 20 per cent a month—can cause massive economic destruction, as the price system breaks down and the possibility of using profit-and-loss calculations to make rational business decisions vanishes. Such episodes of hyperinflation are among the worst economic disasters that can befall an economy.

Strangely, moderate inflation rates—say a little more than 10 per cent a year—are highly unsettling to consumers and business managers. Moderate inflation should not seriously compromise consumers', investors', and managers' ability to determine the best use of their financial resources or to calculate profitability. Yet, all these groups are strongly averse to it. Politicians in the industrialized economies have discovered that if they fail to preside over low and stable inflation rates, then they are likely to lose the next election.

Figure 3.4: Zimbabwe's inflation trend, 1995–2007



Source: Reserve Bank of Zimbabwe



Myth 3: The cost of living has steadily risen throughout the 20th century, especially the last few decades

This myth is based on the fact that the prices of most things are higher than they used to be. Of course some of this is inflation, but even if you discount the inflation, many things cost more real dollars than they used to. Does this mean the cost of living has risen? Not necessarily.

If we compare the increase in prices vis-à-vis the earnings side the higher prices may not be a big deal. When looked at this way, the real cost of living has dropped significantly and consistently over the course of the century and the last few decades.

The average annual inflation rate in Zimbabwe climbed from 22.6 per cent in 1995 to 58.1 per cent by 2000, 365 per cent by 2003 before declining to 237.8 per cent by 2005. However, in 2006, the inflation rate soared to 1000 per cent and by July 2008 it had reached 2.2 million per cent. Such kind of a hyperinflationary environment severely erodes the purchasing power of consumers, disposable incomes of workers, and reduces investor confidence.

(iv) Interest rate

The fourth key economic indicator is the interest rate. Though economists speak of “the” interest rate, there are actually many different interest rates applying to loans of different durations and different degrees of risk. The different interest rates often move up or down together, such that economists speak of the interest rate, referring to the entire complex of different rates.

The interest rate is important because it governs the redistribution of purchasing power across time. Those people or business enterprises who think they can make good use of additional financial resources borrow, promising to return the purchasing power they use today with interest in the future. Those business enterprises or people who have no immediate use for their financial resources lend, hoping to profit when the borrower returns the borrowed sum—what financiers call the principal—with interest.



Activity: Why raise the interest rates?

Question: What happens when the Central Bank raises the interest rates?

Answer: Puts a squeeze on purchases/transactions financed by loans: business investment, mortgages, cars and other big ticket items.

Draw out the following story:

Lack of consumer demand leads businesses to cut back even more by laying off workers. These unemployed workers then cut back their spending, which means even less consumer demand, which leads to more layoffs and so on down along a downward spiral. The result of this would be a recession.

Question: Why in the world would the Central Bank and the International Monetary Fund (IMF) want to cause a recession?

Answer: First it would force people to spend less on imports, which means more foreign exchange to repay foreign debt.

Second, in a recession, the high unemployment creates a downward pressure on wages, which is good for businesses and also helps to put brakes on inflation.

Third, the whole austerity package of recession and government cutbacks is considered a good tonic of market discipline, sort of like fasting—cleans out the system.

(v) Stock market

The level of the stock market is the key economic indicator you hear about most often—you hear about it every single day unless you try hard to avoid the news. The level of the stock market is an index of expectations for the future. When the stock market is high, investors expect economic growth to be rapid, profits to be high, and unemployment to be relatively low. Conversely, when the stock market is low, it is because investors expect the economic future to be relatively gloomy.

Supply stock market data from Lusaka Stock Exchange (LUSE)

Table 3.2: LUSE closing stock prices as at 29 July 2008

Listed Company	Prices (K) (Zambian Kwacha)	Change
African Explosives Zambia Plc	2,000.00	constant
BATA Shoes Company Plc	180.00	constant
British American Tobacco–Zambia	1,799.99	constant
BP Zambia Plc	720.00	Increased, +19.00
Cavmont Capital Holdings Zambia Plc	10.00	constant
Copperbelt Energy Corporation Plc	500.00	constant
CELTEL	770.00	reduced, -30.00
Farmers House Plc	1,500.00	constant
FARM PREF	4,280.00	constant
Investstrust Bank Plc	50.00	constant
Larfarge Plc	6,325.00	Constant
National Breweries Plc	7,400	constant
Pamodzi Hotel Plc	400.00	constant
Shoprite Holdings Limited–RSA	13,000.00	constant
Standard Chartered Bank Plc	540.00	Reduced, -10
ZamBeef Products	6,900.00	constant
Zambian Breweries	2,000.00	Increased, +25.00
Metal Fabricators of Zambia	380.00	Increased, +30.00
ZCCM Investment Holdings Plc	28,000.00	constant
Zambia Sugar Plc	479.00	constant
Stock Index	Reduced, -1.20%	

Source: Lusaka Stock Exchange, Market Summary Report, 29 July 2008

The Lusaka Stock Exchange (LUSE) was established in February 1994. Its formation was part of the Government's economic reform programme aimed at developing the capital market in Zambia. Through its operation, the stock exchange has been attracting both domestic and foreign portfolio investment. The stock exchange has also facilitated the divestiture of government ownership in parastatals and the realization of the objectives of creating a broad and wide shareholding ownership by the citizenry via a fair and transparent process. As at 29 July 2008, the Lusaka Stock Exchange had twenty (20) listed companies and eleven (11) quoted companies. During week-days, the trading sessions (buying and selling of shares) of the stock exchange start at 9:00 a.m. and close at 2.30 p.m. At the end of the day's exchange session, a closing market summary is provided reflecting the closing stock prices for each listed company and an indication of how each listed company's stock price had moved during the exchange sessions. The table below captures a summary of LUSE's stock prices at the close of the exchange sessions on 29 July 2008.

(vi) Exchange rate

The sixth and last key economic indicator is the exchange rate. The exchange rate (also known as the foreign-exchange rate, forex rate or FX rate) between two currencies specifies how much one currency is worth in terms of the other. For example, an exchange rate of 150 Malawian Kwacha (MK) to the United States dollar (US\$) means that MK 150 is worth the same as US\$ 1. The foreign exchange market is one of the largest markets in the world. By some estimates, about US\$ 2 trillion worth of currency changes hands every day.



Myth 4: A weaker national currency is good for the country and its trading situation

While on the surface, there may at least appear to be some truth to this statement, when one looks a little deeper it becomes obvious that this is one of those cases where the costs far outweigh the perceived benefits.

A currency of lower value makes the country's exports more competitive in that it lowers their cost in foreign currencies. In other words, a low value Malawian Kwacha is more competitive in foreign markets. In this case, Malawian exports are then able to more effectively compete in foreign countries where purchases are made in the local currency. In theory, at least, this should help Malawi's trade deficit. The fact of the matter is that it has not. Imported items make up much of Malawian consumption and the price of those items rises as the Kwacha falls.

At the same time, the relative lack of industrial production in Malawi also poses further complications. Much of what Malawi produces locally (tobacco and tea) finds itself in foreign markets as opposed to local shops. Furthermore, this will create an upward pressure on imported goods and it creates a situation where the average Malawian is going to have to start digging under the sofa cushions for coins in order to pay for these items.

The *spot exchange rate* refers to the current exchange rate. The forward exchange rate refers to an exchange rate that is quoted and traded today but for delivery and payment on a specific future date. The nominal exchange rate is the rate at which the monies of different countries can be exchanged one for another. The real exchange rate is the rate at which the goods and services produced in different countries can be exchanged one for another.

Buying and selling foreign exchange

What exactly do you buy or sell when you make a foreign currency transaction? In reality, you are doing both actions, buying and selling. This is why the daily foreign exchange rate boards of Forex Bureaus or tables put in newspapers give both a buying and selling rate for each currency.

What happens is that if you want to get Uganda shillings (UGX) from the forex bureau, you need to sell the foreign currency (say US dollars). Thus, a transaction of buying the UGX/USD at 1720 is actually buying the UGX and selling the dollar at 1720. If the UGX increases in value in relation to the dollar, the price would increase and the trader will make money.

Zimbabwe dollar: A worthless currency



With prices doubling every few days, Zimbabweans now spend huge amounts of time and energy preventing their meagre cash resources from completely evaporating. Trying to catch up with galloping hyperinflation, now officially running at 2.2 million per cent a year and at least four times faster in reality, the Central Bank has been printing ever bigger denominations. But it is outrun by galloping prices: at last count, the most valuable banknote available was for 50 billion Zimbabwean dollars, now worth barely 70 American cents on the black market, and the stock of Zimbabwean dollars is dwindling. Local cash could become more scarce still, now that the German company that was providing Zimbabwe with paper to print its banknotes has cancelled its contract; the Zimbabwean monetary authorities are likely to turn to a less specialized supplier. Meanwhile, people do not even bother to pick up notes of hundreds of thousands on the pavements of Harare, the capital. At independence in 1980, the Zimbabwe dollar was more valuable than the American greenback.

*Extracts from **The Economist** print edition, 17 July 2008*



Activity: Devaluation of the local currency

Materials: Flip chart, pens, fun money or you can just use dummy cheques.

Why devalue?

(a) Break into small groups of about 3 to 4 people. Some are Americans and some are Nigerians. Give each American group 100 US dollars and each Nigerian group 100 Naira. Facilitator plays the banker. Write the exchange rate on the flip chart:

- 1.4 to the US dollar
- US\$0.60 to the Nigeria Naira (N)

Each group asks the banker for so many dollars or Naira in exchange for the currency they are holding (So dollar holders get N140 and the Naira holders get \$60 dollars).

(b) Now write this new exchange rate up:

- N1.6 to the dollar
- US\$ 0.40 to the Naira

Ask participants if the Naira is stronger (appreciated) or weaker (devalued).

Answer: The Naira is weaker, the dollar is stronger.

Hint: Think of the exchange rate as the price of the currency. Therefore, the price of the Naira in dollars has fallen from £0.60 to £0.40—it has become weaker. The price of the dollar in Naira has risen from ₦1.40 to ₦1.60—it has become stronger.

(c) Now each group asks the banker for so many dollars in exchange for the currency they are holding (the dollar holders get 160 Naira and the Naira holders get 40 dollars).

(d) Have each group analyse how this affects:

(i) Exports from Nigeria to the US

Answer: Good—Nigeria exports have become cheaper. A N100 Nigerian barrel of oil now costs a US importer \$40 compared to \$60)

(ii) Imports from US

Answer: Bad—US imports have become more expensive. A \$1 American pen now costs N1.6 instead of N1.4.

(iii) Inflation

Answer: Bad--inflation rises because the imports have gone up.

(e) Why is this desirable from the point of view of the IMF?

Conclusion

- The IMF pushes devaluation because, in theory, it is good for the balance of trade (exports minus imports). It boosts exports and decreases imports. This means that there is more hard currency with which to repay the debt. And remember, the IMF serves as the international debt collection agency. In reality, devaluation may not work. Even if the quantity of exports increases, this may be offset by the fall in the value of exports.
- Devaluation leads to inflation, which hits poor people the hardest.

(b) The economic cycle

The economic cycle (or business cycle) refers to the fluctuations of economic activity about its long term growth trend. The cycle involves shifts over time between periods of relatively rapid growth of output (recovery and prosperity), and periods of relative stagnation or decline (contraction or recession). These fluctuations are often measured using the real gross domestic product. Despite being named cycles, these fluctuations in economic growth and decline do not follow a purely mechanical or predictable periodic pattern.

Macroeconomics could not exist without the economic statistics that are systematically collected and disseminated by governments. Estimates of the value and composition of economic activity are the fundamental data of macroeconomics. We cannot try to explain fluctuations in economic activity unless we know what those fluctuations are. But what is “economic activity”?

Whenever you work for someone and get paid, that is economic activity. Whenever you buy something at a grocery shop, that is economic activity. Whenever the government taxes you and spends the money to build a road or a bridge, that is economic activity. In general, if a flow of money is involved in a transaction, economists will count that transaction as “economic” activity. Overall, economic activity is the pattern of transactions in which resources, labour, goods, and services are created, transformed, and exchanged. If a transaction does not involve exchange for money, governments will not count it as part of “economic activity.”

3.3 Measurement of economic performance

Measures of economic performance are used in economics to estimate the welfare of an economy by totalling the value of goods and services produced in an economy. They use a system of national accounting first

developed during the 1940s. The primary measures of national income and output are Gross Domestic Product (GDP), Gross National Product (GNP), Gross National Income (GNI), Net National Product (NNP), and Net National Income (NNI).

There are three main ways of calculating these numbers; the output approach, the income approach and the expenditure approach. In theory, the three must yield the same, because total expenditures on goods and services (GNE) must equal the total income paid to the producers (GNI), and that must also equal the total value of the output of goods and services (GNP).

However, in practice, minor differences are obtained from the various methods due to changes in inventory levels.

GDP versus GNP

Gross Domestic Product (GDP) is defined as the “value of all final goods and services produced in a country in one year”. On the other hand, Gross National Product (GNP) is defined as the “value of all (final) goods and services produced in a country in one year, plus income earned by its citizens abroad, minus income earned by foreigners in the country”. The key difference between the two is that GDP is the total output of a country, e.g. Zambia, and GNP is the total output of all nationals of a country, e.g. Zambians.

GNP is becoming less used, as a larger number of nationals are working in nations abroad. Because of this, GDP is becoming a more popular measure. A number of ratios are derived from GDP. These include:

- **NDP:** Net domestic product, defined as “gross domestic product (GDP) minus depreciation of capital”, similar to NNP.
- **GDP per capita:** Gross domestic product per capita is the mean value of the output produced per person, which is also the mean income.

These terms often use “expenditure”, or “income” instead of “product”. These are still the same, as for all goods that are produced, an amount of money equal to the value of the goods produced is spent on purchasing the goods, and the money spent purchasing the goods is paid to the workers as income. Therefore, production, expenditures, and income are all equal.



Question and answer

Question: Do you think GDP or GNP is bigger in the case of African countries?

Answer: GDP in most (if not all) African countries is substantially larger than GNP due to all the Multinational Corporations (MNCs) in Africa. This is at odds with the European Union and the US where GDP and GNP are fairly close.

(a) The output approach

The Output Approach focuses on finding the total output of a nation by directly finding the total value of all goods and services a nation produces.

Because of the complication of the multiple stages in the production of a good or service, only the final value of a good or service is included. This avoids an issue often referred to as “double counting”—when the total value of a good is included in the national output in several stages of production. In an example of meat production, the value of the good from the farm may be \$10, then \$30 from the butchers, and then \$60 from the supermarket. The value that should be included in the national output should be \$60, not the sum of all those numbers, that is \$100. Using the method of National Income by Output, Value Added method:

$$\text{GDP at market price} = \text{Value of output in an economy in a particular year} - \text{Intermediate consumption}$$

$$\text{NNP at factor cost} = \text{GDP at market price} - \text{Depreciation} + \text{NFIA}$$

(Net Factor Income from Abroad) - Net indirect taxes

(b) The income approach

The Income Approach focuses on finding the total output of a nation by finding the total income of a nation. This is acceptable, because all money spent on the production of a good—the total value of the good—is paid to workers as income.

The main types of income that are included in this measurement are rent (the money paid to owners of land), salaries and wages (the money paid to workers who are involved in the production process, and those who provide the natural resources), interest (the money paid for the use of man-made resources, such as machines used in production), and profit (the money gained by the entrepreneur—the businessman who combines these resources to produce a good or service).

The equation for measurement of National Income by Income Method:

$$\text{NDP at factor cost} = \text{compensation of employee} + \text{operating surplus} + \text{Mixed income of self employee}$$

$$\text{National Income} = \text{NDP at factor cost} + \text{NFIA (net factor income from abroad)}$$

(c) The expenditure approach

The Expenditure Approach is the most popular national output accounting method. It focuses on finding the total output of a nation by finding the total amount of money spent. This too is acceptable because, like income, the total value of all goods is equal to the total amount of money spent on goods. The basic formula for domestic output combines all the different areas in which money is spent within the region, and then combining them to find the total output.

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

Where

- C = Household consumption expenditures, Personal consumption expenditures
- I = Gross private domestic investment
- G = Government consumption and gross investment expenditures
- X = Gross exports of goods and services
- M = Gross imports of goods and services

Note: $(X - M)$ is often written as NX , which stands for “Net Exports”.

(d) National income and welfare

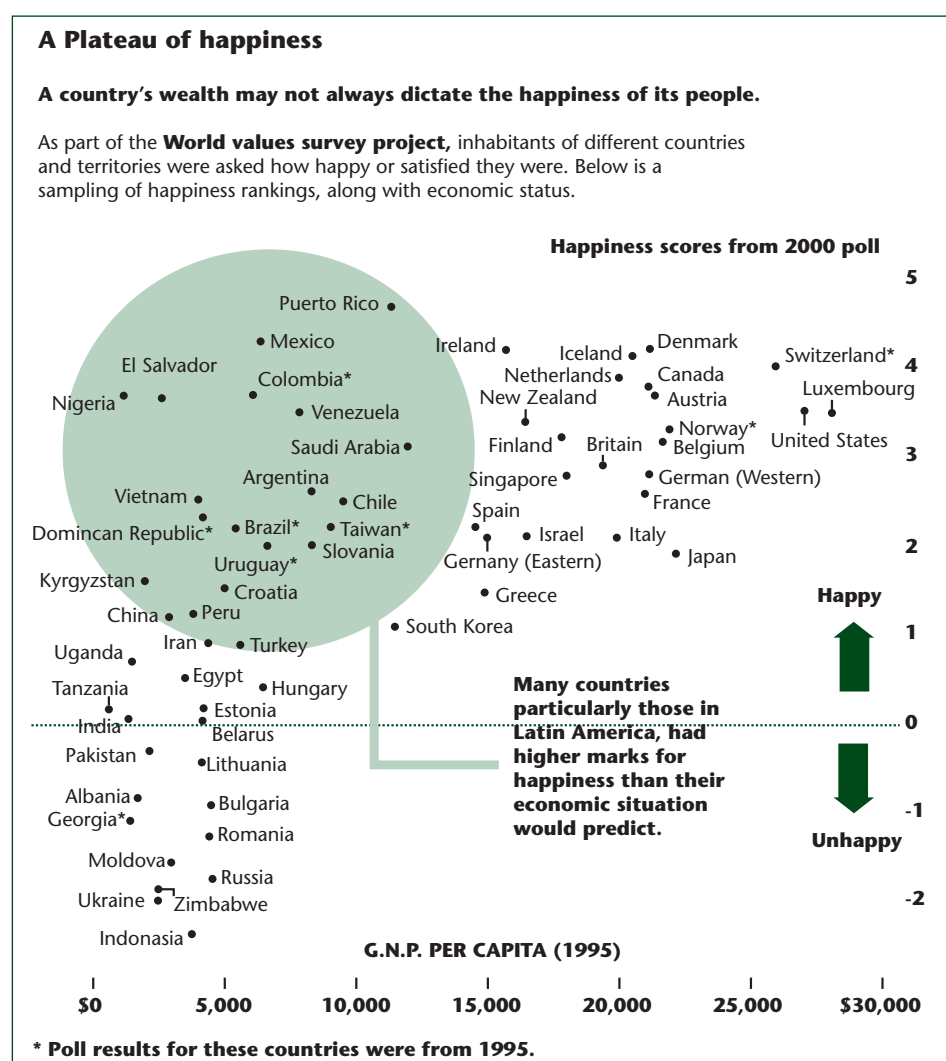
GDP per person is often used as a measure of a country’s welfare. Countries with higher GDP may be more likely to also score highly on other measures of welfare, such as life expectancy. However, there are serious limitations to the usefulness of GDP as a measure of welfare:

- Measures of GDP typically exclude unpaid economic activity, most importantly domestic work such as childcare. This leads to distortions; for example, a paid nanny’s income contributes to GDP, but an unpaid parent’s time spent caring for children will not, even though they are both carrying out the same economic activity.
- GDP takes no account of the inputs used to produce the output. For example, if everyone worked for twice the number of hours, then GDP might roughly double, but this does not necessarily mean that workers are better off as they would have less leisure time. Similarly, the impact of economic activity on the environment is not measured in calculating GDP.
- Comparison of GDP from one country to another may be distorted by movements in exchange rates. Measuring national income at purchasing power parity may overcome this problem at the risk of over-valuing basic goods and services, for example subsistence farming.
- GDP does not measure factors that affect quality of life, such as the quality of the environment (as distinct from the input value) and security from crime. This leads to distortions—for example, spending on cleaning up an oil spill is included in GDP, but the negative impact of the spill on well-being (e.g. loss of clean beaches) is not measured.

- GDP is the mean wealth rather than median wealth. Countries with a skewed income distribution may have a relatively high per capita GDP while the majority of its citizens have a relatively low level of income due to concentration of wealth in the hands of a small fraction of the population.

Because of this, other measures of welfare such as the Human Development Index (HDI), Index of Sustainable Economic Welfare (ISEW), Genuine Progress Indicator (GPI), Gross National Happiness (GNH) and Sustainable National Income (SNI) are used.

Figure 3.5: Alternative measures of human development welfare: Happiness Index



Source: Ronald Inglehart, "Human beliefs and values: A cross-cultural sourcebook based on the 1999-2002 Values Surveys"

The Happy Planet Index (HPI) is an index of human well-being and environmental impact, introduced by the New Economics Foundation (NEF) in July 2006. The HPI is based on general utilitarian principles—that most people want to live long and fulfilling lives, and the country which is doing best is the one that allows its citizens to do so while avoiding infringing on the opportunity of future people and people in other countries to do the same.

Table 3.3: International ranking of HPI, 2006

Rank	Country	HPI	Rank	Country	HPI
1	Vanuatu	68.21	43	Barbados	52.73
2	Colombia	67.24	44	Malaysia	52.69
3	Costa Rica	66.00	45	Palestinian Authority	52.64
4	Dominica	64.55	46	Cape Verde	52.41
5	Panama	63.54	47	Chile	52.20
6	Cuba	61.86	48	Timor	52.04
7	Honduras	61.75	49	Argentina	51.96
8	Guatemala	61.69	50	Trinidad and Tobago	51.87
9	El Salvador	61.66	51	Belize	51.32
10	Saint Vincent and the Grenadines	61.37	52	Paraguay	51.13
11	Saint Lucia	61.31	53	Jamaica	51.01
12	Vietnam	61.23	54	Nepal	49.95
13	Bhutan	61.08	55	Mauritius	49.65
14	Samoa	60.98	56	Mongolia	49.59
15	Sri Lanka	60.31	57	Uruguay	49.31
16	Antigua and Barbuda	59.23	58	Ecuador	49.29
17	Philippines	59.17	59	Uzbekistan	49.22
18	Nicaragua	59.09	60	Grenada	48.96
19	Kyrgyzstan	59.05	61	Austria	48.77
20	Solomon Islands	58.93	62	The Gambia	48.67
21	Tunisia	58.92	63	Brazil	48.59
22	São Tomé and Príncipe	57.92	64	Iceland	48.35
23	Indonesia	57.90	65	Switzerland	48.30
24	Tonga	57.90	66	Italy	48.26
25	Tajikistan	57.66	67	Iran	47.23
26	Venezuela	57.55	68	Ghana	46.98
27	Dominican Republic	57.14	69	Bolivia	46.17
28	Guyana	56.65	70	Netherlands	46.00
29	Saint Kitts and Nevis	56.14	71	Madagascar	45.99
30	Seychelles	56.07	72	Cyprus	45.99
31	China	55.99	73	Algeria	45.89
32	Thailand	55.39	74	Luxembourg	45.62
33	Peru	55.14	75	Bahamas	44.90
34	Suriname	55.03	76	Papua New Guinea	44.75
35	Yemen	55.00	77	Myanmar	44.55
36	Fiji	54.47	78	Belgium	44.04
37	Morocco	54.43	79	Slovenia	44.03
38	Mexico	54.39	80	Oman	43.94
39	Maldives	53.52	81	Germany	43.83
40	Malta	53.26	82	Croatia	43.71
41	Bangladesh	53.20	83	Lebanon	43.64
42	Comoros	52.92			

Rank	Country	HPI	Rank	Country	HPI
84	Taiwan	43.41	125	Kazakhstan	36.92
85	Haiti	43.34	126	Togo	36.86
86	Syria	43.23	127	Kenya	36.70
87	Spain	43.04	128	Czech Republic	36.59
88	Hong Kong	42.88	129	France	36.42
89	Saudi Arabia	42.65	130	Armenia	36.15
90	India	42.46	131	Singapore	36.14
91	Cambodia	42.15	132	Slovakia	35.81
92	Albania	42.13	133	Greece	35.71
93	Jordan	42.05	134	Tanzania	35.08
94	New Zealand	41.92	135	Guinea Bissau	35.08
95	Japan	41.70	136	Portugal	34.83
96	Republic of the Congo	41.59	137	Eritrea	34.49
97	Egypt	41.58	138	Bahrain	34.35
98	Turkey	41.40	139	Australia	34.06
99	Denmark	41.40	140	Mali	33.68
100	Brunei	41.16	141	Mozambique	33.01
101	Georgia	41.15	142	Cameroon	32.76
102	South Korea	41.11	143	Djibouti	32.72
103	Bosnia and Herzegovina	40.96	144	Ethiopia	32.53
104	Senegal	40.81	145	Bulgaria	31.59
105	Azerbaijan	40.69	146	Nigeria	31.14
106	Gabon	40.52	147	Moldova	31.12
107	Libya	40.33	148	Burkina Faso	30.08
108	United Kingdom	40.29	149	Lithuania	29.29
109	Laos	40.26	150	United States	28.83
110	Benin	40.10	151	Côte d'Ivoire	28.80
111	Canada	39.76	152	Rwanda	28.35
112	Pakistan	39.40	153	Sierra Leone	28.24
113	Ireland	39.38	154	United Arab Emirates	28.20
114	Poland	39.29	155	Angola	27.88
115	Norway	39.18	156	South Africa	27.80
116	Republic of Macedonia	39.14	157	Sudan	27.74
117	Israel	39.07	158	Uganda	27.68
118	Namibia	38.41	159	Kuwait	27.67
119	Sweden	38.17	160	Latvia	27.27
120	Romania	37.72	161	Niger	26.80
121	Hungary	37.64	162	Malawi	26.66
122	Guinea	37.42	163	Zambia	25.91
123	Finland	37.36	164	Central African Republic	25.90
124	Mauritania	37.30	165	Belarus	25.78
			166	Qatar	25.50

Rank	Country	HPI	Rank	Country	HPI
167	Botswana	25.42	174	Ukraine	22.21
168	Chad	25.37	175	Democratic Republic of the Congo	20.69
169	Turkmenistan	23.96			
170	Equatorial Guinea	23.77	176	Burundi	19.02
171	Lesotho	23.05	177	Swaziland	18.38
172	Russia	22.76	178	Zimbabwe	16.64
173	Estonia	22.68			

Source: Wikipedia, the free encyclopedia, accessed on 10 July 2008



Question and answer

Question: Is GDP growth a good measure of economic development?

Answer: Problems with using GNP/GDP growth as a measure of progress or development:

- Does not count unpaid labour, especially women's care work (childrearing, eldercare, among others).
- Does not count externalities—costs that are externalized (passed on) to someone else. For example, polluting factories are able to pass on the cost of damage to health and the environment.
- Does count negative goods—the clean up of a toxic waste dump is counted as a plus in terms of GDP.
- Ignores distribution, quality of life, equality, sustainability.
- Ignores the question of whether the world can sustain high rates of growth given the depletion of non-renewable resources and environmental damage.

3.4 Monetary policy: Money supply and money demand

(a) What is money?

No other subject in economics has been studied longer or more intensively than the subject of money. The result is a vast amount of documented experience and a well developed body of theoretical analysis.

Money is a commodity accepted by general consent as a medium of economic exchange. It is the medium in which prices and values are expressed. Money is used to facilitate trade, and it is the principal measure of wealth.

The subject of money has fascinated people from the time of Aristotle to the present day. The piece of paper labelled 1 Dollar, 10 Euros, 100 Rands, or 1,000 Kwachas is little different as paper from a piece of the same size torn from a newspaper or magazine, yet it will enable its bearer to command some measure of food, drink, and clothing. This is because people accept money as such because they know that others will also accept it.

Functions of money

Money has four major functions. It is a:

Medium of exchange

Whatever people usually give in exchange for the things that they buy is the medium of exchange. As we have seen, this is the function that defines money.

Unit of account

The unit of account is the unit in which values are stated, recorded and settled. The differences between this and the medium of exchange may seem subtle, but there are a few cases in which the unit of account is different from the unit in which the medium of exchange is expressed.

Standard of deferred payment

This is the unit in which debt contracts are stated. Deferred payment means a payment made in the future, not now. Here, again, it is usually the same as the medium of exchange, but not always. During periods of inflation, people may accept paper money for immediate payment, but insist on some other medium, such as real goods and services or gold, for deferred payment—because the medium of exchange would lose much of its value in the meanwhile.

Store of value

Again, this is something that people keep in order to maintain the value of their wealth. Again, while it would usually be the same as the medium of exchange, in inflationary times other media might be substituted, such as jewellery, land or collectable goods. In this sense, money is “set aside” for the future.

Early history of money

Money has been used for something like 3000 years. City-states in the ancient near East had extensive trade from city to city, and they used precious metals as a medium of exchange. When trades were settled, a certain amount of metal could be used to settle the difference. There was a problem of quality control, however. There were also problems of determining that the quantity and purity of the metal was as agreed.

The answer was quality control and certification. The early kings of Lydia standardized the chunks of metal and guaranteed their quality by stamping the King's picture on them. These were the first coins. This guarantee

of quality by the Lydian kingdom was very successful, and made the Kingdom of Lydia even richer.

But what Lydia could do, other kingdoms could also do. By 1000 AD, metallic coin monetary systems had spread through much of the old world.

As in so many other things, the Chinese were the innovators for the next step. The Chinese invented printing, and not too much later, they also invented paper money. It was widespread in China by around 1000 AD, but the Chinese abandoned it after about 1500 in the general decline of Chinese society after the Mongol conquest.

Paper money was to evolve much more indirectly in Europe, though.

Modern monetary systems: US dollar and electronic money

During World War II, Great Britain and the United States outlined the post-war monetary system. Their plan, approved by more than 40 countries at the Bretton Woods Conference in July 1944, aimed to correct the perceived deficiencies of the interwar gold exchange standard. The agreement that resulted from the conference led to the creation of the International Monetary Fund (IMF), which countries joined by paying a subscription.

Post-war recovery, low inflation, growth of trade and payments, and the build-up of international reserves in industrial countries permitted the new system to come into full operation at the end of 1958. Although a vestigial tie to gold remained, with the gold price staying at \$35 per ounce, the Bretton Woods system essentially put the market economies of the world on a dollar standard—in other words, the US dollar served as the world's principal currency, and countries held most of their reserves in interest-bearing dollar securities. The dollar became the most widely used currency in international trade, even in trade between countries other than the United States.

In most countries, the bulk of the currency consists of notes issued by the Central Bank, for example Central Bank of Kenya, Bank of England, Federal Reserve Bank of South Africa, the Bank of Zambia, and so on. The other major item of currency held by the public is coins. In almost all countries, this is token coin whose worth as metal is much less than its face value.

In countries with a history of high inflation, the public may choose to use foreign currency as a medium of exchange and a standard of value. The US dollar has been chosen most often for these purposes and, although other currencies have had lower average inflation rates than the dollar in the years since World War II, the dollar compensates by having lower costs of information and recognition than any other currency. Societies agree on the use of dollars not by a formal decision but from knowledge that others recognize the dollar and accept it as a means of payment. At

the turn of the 21st century, estimates suggested that as much as two-thirds of all dollars in circulation were found outside the United States.

In addition to currency, bank deposits are counted as part of the money holdings of the public. In the 19th century, most economists regarded only currency and coin, including gold and other metals, as “money.” They treated deposits as claims to money. As deposits became more and more widely held and as a larger fraction of transactions were made by cheque, economists started to include not the cheques but the deposits they transferred as money on a par with currency and coin.

Centuries of innovation have changed the ways in which the public conducts transactions. Credit cards, debit cards, and automatic transfers are among the many innovations that emerged in the years after World War II.

A credit card is not money. It provides an efficient way to obtain credit through a bank or financial institution. It is efficient because it obviates the seller’s need to know about the credit standing and repayment habits of the borrower. For a fee that each subscribing merchant agrees to pay, the bank issues the credit card, makes a loan to the buyer, and pays the merchant promptly. The buyer then has a debt that he or she settles by making payment to the credit card company. Instead of carrying more money, or making credit arrangements with many merchants, the buyer makes a single payment for purchases from many merchants. The balance can be paid in full, usually on a monthly basis, or the buyer can pay a fraction of the total debt, with interest charged on the remaining balance.

Before credit cards existed, a buyer could arrange a loan at a bank. The bank would then credit the buyer’s deposit account, allowing the buyer to pay for his or her purchases by writing cheques. Under this arrangement, the merchant bore more of the costs of collecting payment and the costs of acquiring information about the buyer’s credit standing. With credit cards, the issuing company, often a bank, bears many of these costs, passing some of the expenses along to merchants through the usage fee.

A debit card differs from a credit card in the way the debt is paid. The issuing bank deducts the payment from the customer’s account at the time of purchase. The bank’s loan is paid immediately, but the merchant receives payment in the same way as with the use of a credit card. Risk to the lending institution is reduced because the electronic transmission of information permits the bank to refuse payment if the buyer’s deposit balance is insufficient.

Items used as money in modern financial systems possess various attributes that reduce costs or increase convenience. Units of money are readily divisible, easily transported and transferred, and recognized instantly. Legal tender status guarantees final settlement. Currency protects anonymity, avoids record keeping, and permits lower costs of payment. However, currency can be lost, stolen, or forged; therefore, it is used most often for relatively small transactions or where anonymity is valued.

Information processing reduces costs of transfer, record keeping, and the acquisition of information. “Electronic money” is the name given to several different ways in which the public and financial and non-financial firms use electronic transfers as part of the payments system. Since most of these transfers do not introduce a new medium of exchange (i.e., money), electronic transfer is a more appropriate name than electronic money.

(b) Monetary policy

Monetary policy is the process by which the government, Central Bank, or monetary authority of a country controls: (i) the supply of money; (ii) availability of money, and; (iii) cost of money or rate of interest, in order to attain a set of objectives oriented towards the growth and stability of the economy.

Monetary policy is generally referred to as either being an expansionary policy, or a contractionary policy. An expansionary policy increases the total supply of money in the economy, and a contractionary policy decreases the total money supply.

Expansionary policy is traditionally used to combat unemployment in a recession by lowering interest rates, while contractionary policy involves raising interest rates in order to combat inflation. Monetary policy should be contrasted with fiscal policy, which refers to government borrowing, spending and taxation.

The money supply, or money stock, refers to the total amount of money held by the non-bank public at a point in time in an economy. There are several ways to measure such an amount (called a monetary aggregate), but each includes currency in circulation plus demand deposits (current-account money).

Since most modern economic systems are regulated by governments through monetary policy, the supply of money is broken down into types of money based on how much of an effect monetary policy can have on that type of money. Narrow money is the type of money that is more easily affected by monetary policy, whereas broad money is more difficult to affect through monetary policy. Narrow money exists in smaller quantities while broad money exists in much larger quantities. Each type of money can be classified by placing it along a spectrum between narrow (easily affected) and broad (difficult to affect) money.

The different types of money are typically classified as Ms. The number of Ms usually range from M0 (most narrow) to M3 (broadest), but which Ms are actually used depends on the system. The typical layout for each of the Ms is as follows:

- **M0:** Physical currency. This is a measure of the money supply that combines any liquid or cash assets held within a Central Bank and the amount of physical currency circulating in the economy. M0 (M-zero) is the most liquid measure of the money supply. It only includes cash or assets that could quickly be converted into currency. This measure is known as narrow money because it is the smallest measure of money supply.

- **M1: M0 + demand deposits, which are checking accounts.** This is used as a measurement by economists trying to quantify the amount of money in circulation. The M1 is a very liquid measure of the money supply, as it contains cash and assets that can quickly be converted to currency.
- **M2: M1 + small time deposits, savings deposits, and non-institutional money-market funds.** M2 is a broader classification of money than M1. Economists use M2 when looking to quantify the amount of money in circulation and trying to explain different economic monetary conditions. M2 is a key economic indicator used to forecast inflation.
- **M3: M2 + all large time deposits, institutional money-market funds, short-term repurchase agreements, along with other larger liquid assets.** This is the broadest measure of money; it is used by economists to estimate the entire supply of money within an economy.

Types of monetary policy

In practice, all types of monetary policy involve modifying the amount of base currency (M0) in circulation. This process of changing the liquidity of base currency through open sales and purchases of (government-issued) debt and credit instruments is called open market operations (OMOs).

Constant market transactions by the monetary authority modify the supply of currency and this impacts other market variables such as short term interest rates and the exchange rate.

The distinction between the various types of monetary policy lies primarily with the set of instruments and target variables that are used by the monetary authority to achieve their goals.

Table 3.4: Types of monetary policy

Monetary policy	Target market variable	Long term objective
Inflation targeting	Interest rate on overnight debt	A given rate of change in the CPI
Price level targeting	Interest rate on overnight debt	A specific CPI number
Monetary aggregates	Growth in money supply	A given rate of change in the CPI
Fixed exchange rate	Spot price of the currency	The spot price of the currency
Gold standard	Spot price of gold	Low inflation as measured by the gold price
Mixed policy	Usually interest rates	Usually unemployment + CPI change

- **Inflation targeting:** Under this policy approach, the target is to keep inflation under a particular definition, such as Consumer Price Index, within a desired range. The inflation target is achieved through periodic adjustments to the Central Bank interest rate target. The interest rate used is generally the inter-bank rate at which banks lend to each other overnight for cash flow purposes. The inflation targeting approach to monetary policy approach was pioneered in New Zealand. It is currently used in Australia, Canada, Chile, the Eurozone, New Zealand, Norway, Poland, Sweden, South Africa, Turkey, and the United Kingdom.
- **Price level targeting:** Price level targeting is similar to inflation targeting, except that CPI growth in one year is offset in subsequent years, such that over time, the price level on aggregate does not move. Something akin to price level targeting was tried by Sweden in the 1930s and seems to have contributed to the relatively good performance of the Swedish economy during the Great Depression. As of 2004, no country operates monetary policy based on a price level target.
- **Monetary aggregates:** In the 1980s, several countries used an approach based on a constant growth in money supply. This approach was refined to include different classes of money and credit (M0, M1, and so on). In the US, this approach to monetary policy was discontinued with the selection of Alan Greenspan as Fed Chairman. This approach is also sometimes called monetarism.
- **Fixed exchange rate:** This policy is based on maintaining a fixed exchange rate with a foreign currency. There are varying degrees of fixed exchange rates, which can be ranked in relation to how rigid the fixed exchange rate is with the anchor nation.
- **Gold standard:** The gold standard is a system in which the price of the national currency is measured in units of gold bars and is kept constant by the daily buying and selling of base currency to other countries and nationals (i.e. open market operations). The selling of gold is very important for economic growth and stability. Today, this type of monetary policy is not used anywhere in the world, although a form of gold standard was used widely across the world prior to 1971.
- **Mixed policy:** In practice, a mixed policy approach is similar to “inflation targeting”. However, some consideration is also given to other goals such as economic growth, unemployment and asset bubbles. This type of policy was used by the US Federal Reserve in 1998.

3.5 Fiscal policy

Fiscal policy refers to government policy that attempts to influence the direction of the economy through changes in government taxes, or through some spending (fiscal allowances). The two main instruments of fiscal policy are government spending and taxation. Changes in the level

and composition of taxation and government spending can impact on the following variables in the economy:

- Aggregate demand and the level of economic activity
- Pattern of resource allocation
- Distribution of income

The three possible stances of fiscal policy are neutral, expansionary and contractionary:

- A neutral stance of fiscal policy implies a balanced budget where $G = T$ (Government spending = Tax revenue). Government spending is fully funded by tax revenue and, overall, the budget outcome has a neutral effect on the level of economic activity.
- An expansionary stance of fiscal policy involves a net increase in government spending ($G > T$) through a rise in government spending or a fall in taxation revenue or a combination of the two. This will lead to a larger budget deficit or a smaller budget surplus than the government previously had, or a deficit if the government previously had a balanced budget. Expansionary fiscal policy is usually associated with a budget deficit.
- Contractionary fiscal policy ($G < T$) occurs when net government spending is reduced either through higher taxation revenue or reduced government spending or a combination of the two. This would lead to a lower budget deficit or a larger surplus than the government previously had, or a surplus if the government previously had a balanced budget. Contractionary fiscal policy is usually associated with a surplus.

Example: Taxation levels in Zimbabwe

Zimbabwe is regarded as the country with the highest taxation levels globally. Below is a breakdown of the tax bands from June to December 2008.

Amount (Z\$)	Tax band (%)
0 – 25,000,000,000	0.0
25,000,000,001 – 50,000,000,000	25.0
50,000,000,001–100,000,000,000	30.0
100,000,000,001 – 150,000,000,000	35.0
150,000,000,001 – 225,000,000,000	40.0
225,000,000,001 – 300,000,000,000	45.0
300,000,000,001 and above	47.5

Source: Zimbabwe Revenue Authority, 2008

The table above shows that the tax bands are narrow, with the highest income tax band pegged at nearly 50 per cent of an individual gross salary. In fact, the Zimbabwe 2008 National Budget revealed that workers are highly taxed, contributing 25 per cent of the total revenues while company taxes contribute only 16 per cent of the total revenues. The position of trade unions has been that the welfare of the worker remains important for productivity to be maximized and hence taxing someone earning below the poverty datum line (PDL) is not only immoral but also regressive.

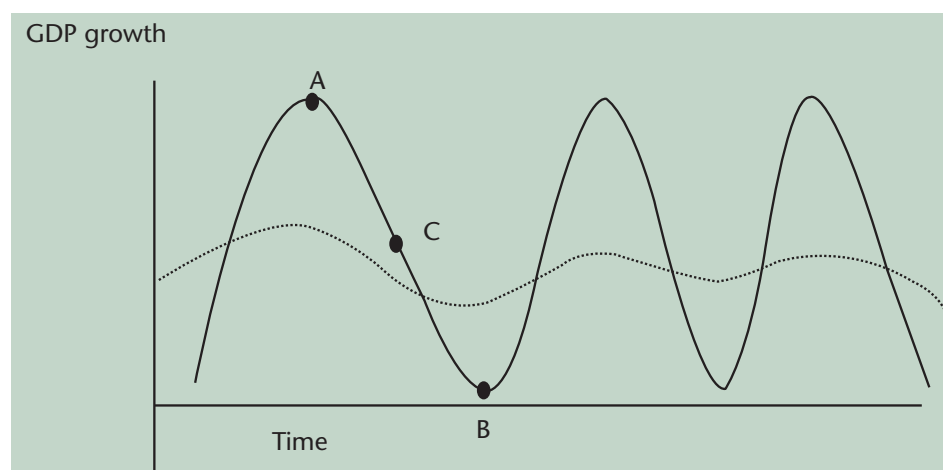
Review of macroeconomic policy

The government uses macroeconomic policy (or macro policy) to try to manage the economy. Capitalism goes through 'booms' and 'busts'—these are called business cycles. An active macro policy tries to smooth out the business cycle by balancing growth, unemployment and inflation. Policies that reduce unemployment might lead to a rise in inflation, while keeping the lid on inflation may prevent growth in jobs. Thus, there is often a political struggle over what is an acceptable level of inflation and what is an acceptable level of unemployment.

The business cycle and the Phillips curve

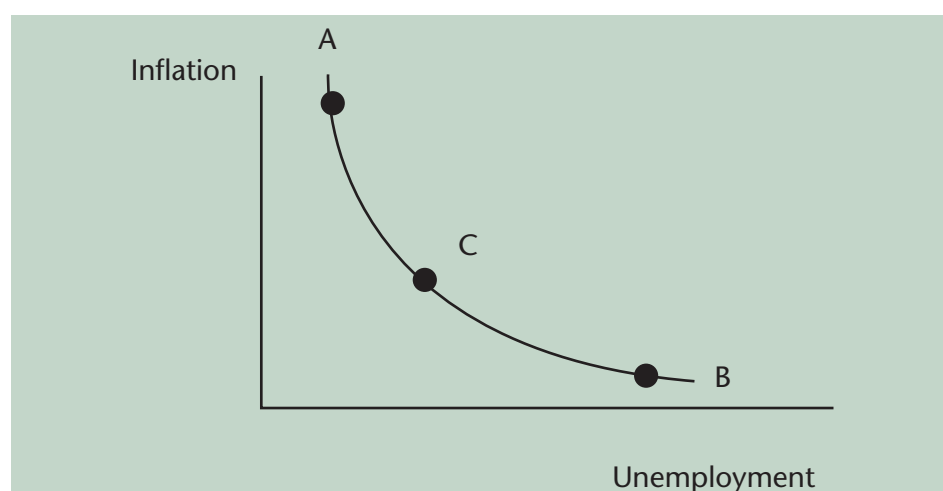
The solid line represents the economic booms and busts as measured by GDP growth. The dotted line represents a tamed business cycle in which the wild boom and bust cycle has been replaced by moderate ups and downs.

Figure 3.6: The business cycle graph



The *Phillips curve* below depicts the relationship between inflation and unemployment. Generally, they move in opposite directions.

Figure 3.7: Phillips curve



Point A in both graphs is at the top of the boom. There is high growth and very low unemployment (in other words, close to full employment). Inflation tends to be high because: (i) employers raise wages in order to attract workers who are in scarce supply; (ii) workers are emboldened to push for higher wages; (iii) businesses raise prices in response to strong consumer demand (all those folks with jobs and flush wallets).

Conversely, at **Point B** the economy is in a slump. Growth is low or even negative (i.e. output is shrinking). Unemployment is very high and, therefore, workers are not buying. Inflation tends to be low as wages fall and businesses drop, or at least do not raise their prices because they are not selling all their stock.

Keynesian macro policy shoots for **Point C**—moderate growth, moderate unemployment and moderate inflation. Keynesian macro policy seeks to tame the business cycle (this is shown as the dotted line on the business cycle graph).

Neoliberal macro policy is far more concerned about keeping inflation down, even at the expense of growth and employment.

Tools of macro policy: Fiscal and monetary policy

Governments have two tools, fiscal and monetary policy, which are used to balance growth, inflation and unemployment by affecting aggregate demand (AD). Aggregate means total, so aggregate demand is the total demand in a country for goods and services. Fiscal policy affects AD through government expenditures or through tax changes. Monetary policy affects AD through the money supply and interest rates.

(a) Fiscal policy

↑G (government spending)	↑ investment
G (government spending)	investment
↑T (taxes)	↑ employment
T (taxes)	employment
M (money supply)	↑AD (aggregate demand)
↑M (money supply)	AD (aggregate demand)
↑interest rates	↑inflation
interest rates	inflation

In the face of a recession, the government could use expansionary fiscal policy.

There are four components of aggregate demand: $AD = C + I + G + (X - M)$

- I = investment–Business demand for goods and services. This is the most volatile component.
- C = consumption–Consumer demand for goods and services. This is the largest component.
- G = Government expenditures–Government demand for goods and services.
- $X - M$ = Exports minus imports = Net exports (could be positive or negative)

Expansionary Fiscal policy

↑G or T → ↑AD → ↑investment → ↑employment → ↑AD → ↑investment → ↑employment → ↑AD and so on.

Narrative:

In the face of a recession, the government would use expansionary fiscal policy:

- Raise government expenditures (G) or lower the taxes (T)
- Aggregate demand (AD), or spending on goods and services, is raised either directly through higher government expenditures (G) or due to lower taxes (T), giving consumers more money to spend
- Businesses respond to the increased demand for their goods and services by increasing business investment
- As businesses invest more, they hire more workers, increasing employment
- There are now more workers with a pay cheque and their spending creates an increase in AD for goods and services
- Businesses respond to the increased AD for their products by increasing business investment
- As businesses invest more, they hire more workers, increasing employment
- More workers with a pay cheque and their spending creates an increase in AD for goods and services, and so on

The total change in AD is greater than the initial amount of government expenditure due to the multiplier effect. This is due to the ripple effect of the change in government spending or taxes.

Now what is happening to inflation? Well, at some point, it is likely to rise as AD (spending) outstrips the aggregate (total) supply (AS) of goods and services. In other words, businesses can hardly keep up with orders and respond to the 'excess' demand by raising their prices. Employers may also be forced to raise wages in order to attract new workers and retain old workers, both of whom are spoiled for choice in the job market.



Small group activity (15 min)

Groups have 10 minutes to put together the fiscal policy response.

Scenario: Imagine that inflation is running above the target level of 2 per cent. What would the government do?

Have one small group present and explain their sequence.

Contractionary fiscal policy:

G or ↑ T → AD → investment → employment → AD → investment →
employment → AD → inflation and so on.

Narrative:

In the face of too much inflation, the government would use contractionary fiscal policy: lower government expenditures (G) or raise taxes (T)—either of which would lower AD. Business responds to the decreased demand for their goods and services by cutting back on investment and laying off workers. Employment decreases and unemployed workers cut back their spending, creating a decrease in AD. Businesses respond to the decreased AD for their products by lowering investment and laying off more workers. This creates less AD and so on.

What is happening to inflation? It is likely to be falling as there is not enough demand (AD) to buy up the supply (AS) of goods and services. As business inventories pile up in their warehouses, they resort to lowering their prices. Workers may be forced to forego pay increases and even accept pay cuts as the level of unemployment rises. Workers count themselves lucky to have a job at all. All of this means a fall in the rate of inflation, which is the point of the whole exercise.

Debate about expansionary fiscal policy

Supporters of conservative economics argue that expansionary fiscal policy is likely to lead to inflation because if the economy is growing very rapidly and the demand for goods, services and labour is outstripping supply, then the price of all of these factors will rise.

They also criticise expansionary fiscal policy because it generally means that the government has to go into debt to pay for the increase in expenditures or a tax cut. This is called deficit spending and is covered by the sale of government bonds (IOUs).

Supporters of conservative economics, because of their belief in minimal government, are generally opposed to increases in government spending, especially deficit spending, even if it is for the purpose of stimulating the economy. The irony is that these folks are happy enough with massive deficit spending for military purposes. Therefore, some of the biggest economic stimulus packages in history have been in the form of warfare. The Economic and Monetary Union has restricted the ability of governments to use fiscal policy due to the limit on national deficits of 3 per cent of GDP. This means that the government is limited in its ability to borrow for the purpose of pursuing an expansionary fiscal policy. Conservatives argue that placing a limit on national deficits is good for economic growth and price stability.

Critics argue that government must be free to pursue expansionary fiscal policy in order to address problems of unemployment, inequality and

poverty. They argue that the single-minded concern with inflation over unemployment hurts the vast majority of people.

(b) Monetary policy

Monetary policy works through changes in the money supply and interest rates.

Demonstration:

$\uparrow M \rightarrow \text{interest rates} \rightarrow \uparrow \text{investment} \rightarrow \uparrow \text{employment} \rightarrow \uparrow AD \rightarrow \uparrow \text{investment}$
 $\rightarrow \uparrow \text{employment} \rightarrow \uparrow AD \text{ and so on.}$

Narrative:

In the face of a recession and high unemployment, the Central Bank would use expansionary monetary policy to stimulate demand.

- The Central Bank would expand money supply (M)
- This would bring down interest rates. You can think of the interest rate as the price of money. If the supply of money increases relative to the demand, the price (interest rate) falls
- The lower interest rates mean that it is cheaper to borrow money, which stimulates business investment
- As businesses invest more, they hire more workers, increasing employment
- There are now more workers with a pay cheque and their spending creates an increase in AD for goods and services
- Businesses respond to the increased AD for their products by increasing investment and employment
- This creates more AD, and so on



Group activity

Scenario:

Imagine that inflation in the Eurozone was running above the target level of 2 per cent. Show what the European Central Bank would do?

$M \rightarrow \text{interest rates} \rightarrow \text{investment} \rightarrow \text{employment} \rightarrow AD$
 $\rightarrow \text{inflation and so on.}$

Narrative:

The Bank would tighten (decrease) the money supply (M), which would increase interest rates. The higher interest rates decreases business investment and firms lay off workers, raising unemployment. Unemployed workers cut back spending and demand (AD) falls. As demand falls relative to supply the price level falls and inflation is reined in.

Trade unions and fiscal policy in Zambia

Trade unions in Zambia have acted on present possibilities to engage the budget process. This engagement is at two main levels:

- Pre-budget input
- Post-budget analysis

The pre-budget input involves a pre-budget workshop aimed at building consensus within labour on key budget issues. It also serves to consolidate the input of labour at the national level. This consensus building workshop is held annually, usually in the third quarter of the year preceding the announcement of budget. This consolidated input then becomes a basis for labour's expectation of the national budget.

The post-budget analysis involves carrying out an in-depth and wide assessment of the national budget when it is released by the Government. This analysis leads to the production of a statement that is released to the general public at the time of heightened interest and a detailed position paper submitted to the National Assembly that debates and approves the national budget.

Overall, the trade unions have engaged the budget process to influence government fiscal policy and ensure that it operates in a way that incorporates labour concerns.

3.6 Economic growth and productivity**(a) Importance of productivity in economic growth**

The section examines how long-run economic growth occurs. Here, we need to understand the role of productivity in raising real output and standard of living, and the role of investment in human capital formation and physical capital accumulation, research and development, and technical progress in raising productivity.

The level of productivity in a country, industry, or enterprise is determined by a number of factors. These include the available supplies of labour, land, raw materials, capital facilities, and mechanical aids of various kinds. Included also are the education and skills of the labour force; the level of technology; methods of organizing production; the energy and enterprise of managers and workers; and a range of social, psychological, and cultural factors that underlie and condition economic attitudes and behaviour.

Productivity in economics refers to measures of output from production processes per unit of input. Usually, this ratio is in the form of an average, expressing the total output of some category of goods divided by the total input of, say, labour or raw materials. In principle, any input can be used in the denominator of the productivity ratio. Thus, one can speak of the productivity of land, labour, capital, or sub-categories of any of these factors of production.

However, labour is by far the most common of the factors used in measuring productivity. One reason for this is, of course, the relatively large share of labour costs in the value of most products. A second reason is that labour inputs are measured more easily than others, such as capital. In addition, statistics of employment and labour-hours are often readily available, while information on other productive factors may be difficult to obtain.

The productivity of land, though it receives considerably less attention than the productivity of labour, has been of historical interest. In ancient and pre-industrial times, the products of the soil constituted the bulk of total output and land productivity and, thus, constituted the major ingredient in a people's standard of living. Soil of low productivity could, and over much of the Earth still does, mean poverty for a region's inhabitants. It is, however, no longer generally believed, as it was in past centuries, that a country's economic well-being is inevitably tied to the productive powers of the land, and the productive potential of the land itself has proved to be not fixed but greatly expandable through the use of modern agricultural methods.

The productivity of capital—plant, equipment, tools, and other physical aids—is a subject of long-standing interest to economists, though concern with its empirical aspects is of more recent origin. Improved statistical reporting and availability of data in some industrially advanced countries have encouraged systematic efforts to measure the productivity of this factor. Compared with achievements in measuring labour productivity, however, the progress realized has been quite limited. There are considerable theoretical and practical difficulties to be overcome.

(b) Why trade unions are interested in productivity

The main objective of trade unions is to improve the standard of living of workers. This can be achieved only if jobs of high quality (decent jobs) are created and wealth is generated. It has been established beyond doubt that high productivity leads to higher living standards via wealth

creation. Therefore, if productivity increases, living standards of workers can increase. Naturally, trade unions are interested in productivity improvement because they believe that it is one effective way by which they can achieve their ultimate goal of enhancing the living standards of not only their members but the living standards of all workers and their families.

However, it is not automatic that productivity improvement will lead to improved living standards for all workers. This is because distribution of wealth in a country and at the work place matters. If a few senior and managerial staff are entitled to a disproportionately large share of a firm's revenue and the majority of workers are entitled to only a small per cent of the firm's revenue, improved productivity will mean improved living standard for a few. This analysis can be generalized to cover the entire economy. That is why unions should not be interested only in productivity improvement but also how to share the fruits of higher productivity, such that every worker will benefit.

Productivity and incomes

There is a strong macroeconomic and statistical evidence that the more effective or productive the national economy, the higher the personal income of workers. At the enterprise level, when productivity is high the employer will have the ability to pay higher income. The union will achieve improved wages and salaries for their members and of course the dues that members will pay will also increase.

Productivity and poverty reduction

When a country is productive, it means more national income for social distribution for the young, old, and handicapped. Higher productivity also leads to higher profits for investment and ultimately to economic growth. Therefore, high productivity packaged with good distributional and development policy such as education, health and social protection is the best available means for poverty reduction.

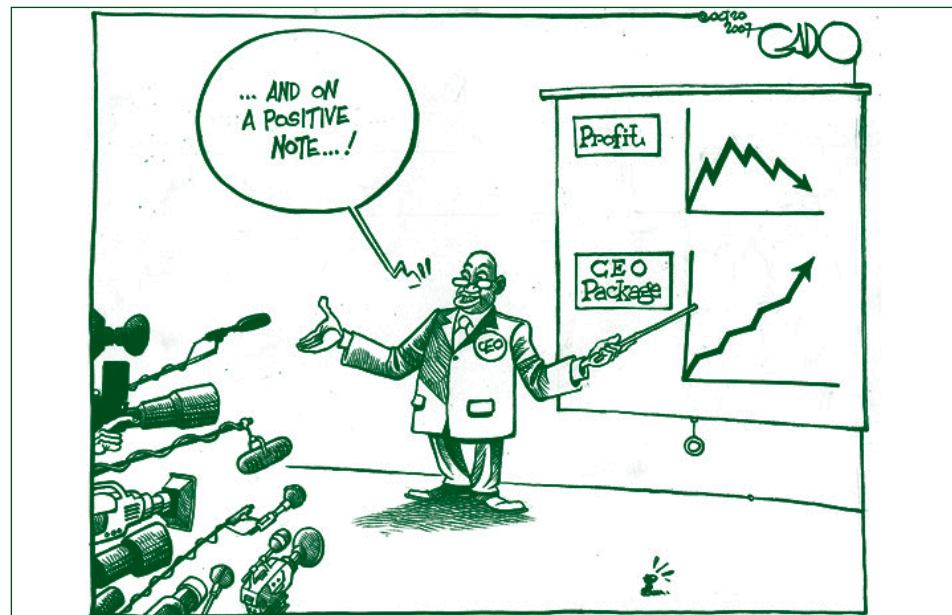
Productivity and promotion of employment

The more productive an economy, the more competitive that economy is in the global markets and the lower the unemployment rate in that country. At the micro level, the more productive a company, the more competitive it is in the economy and the more profits it can generate. If favourable conditions are created for investments and the company ploughs back part of its profits in new investments, new jobs will be created and unemployment will reduce. The social benefits of full employment are obvious.

Productivity and labour standards

The observance of the principles underlying international labour standards contributes to long-term productivity and competitiveness. A sure way of promoting labour standards practically is to promote them in a package with measures for productivity improvement. Also, productivity growth could provide a stronger financial base for introducing more

labour standards without undermining competitiveness. Therefore, if productivity movement is properly introduced into company and country strategies, it has the potential of promoting decent working conditions and improvement in the quality of life in the country.

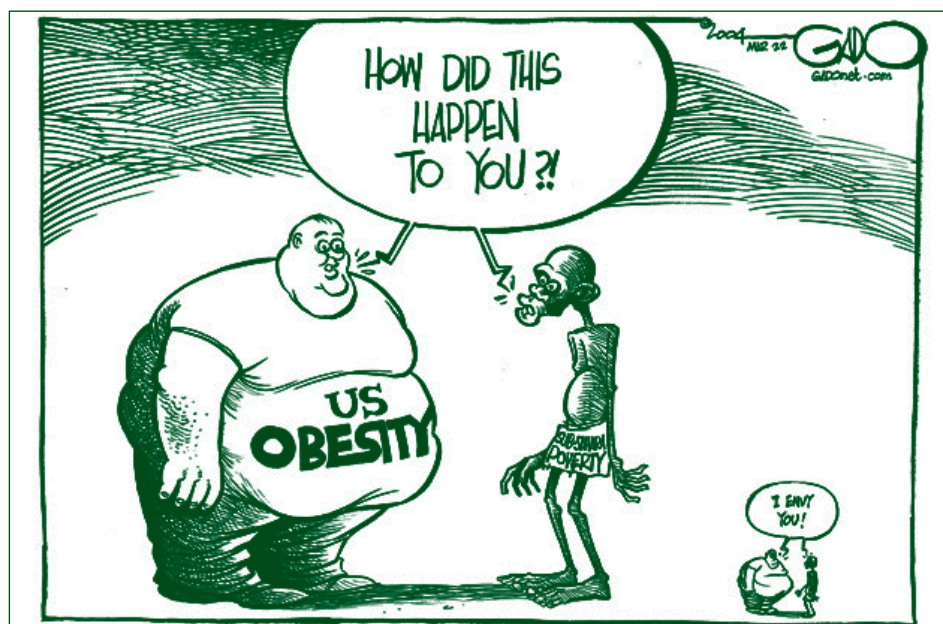


Daily Nation, 10 January 2007. <http://www.gadonet.com>



Activity: Productivity and economic growth

1. Explain productivity using your own words?
2. If your native language is not English, can you think of one word in your native language that means productivity? In what context is this word commonly used?
3. What, in your opinion, are the constraints to measuring productivity in your organization and your country?
4. Suggest ways of improving the measurement of productivity in your organization and your country.
5. Would education and training automatically lead to increased productivity and higher earnings? How can this relationship be reinforced?



Daily Nation, 22 March 2004. <http://www.gadonet.com>



Activity: Poverty reduction strategy–role play (1 hr 10 min)

Objectives:

To reflect on the poverty reduction strategy for your country.

Tasks:

1. Divide the participants in to three groups as follows:

Group 1: women and youth

Group 2: trade unions

Group 3: business and development organizations

2. Ask each group to develop a Poverty Reduction Strategy (20 min).

Remind the groups that they will each have 2-3 minutes to present their strategy. They should consider the following questions:

- What targets would you set? Pay particular attention to GDP growth. Would you include it? If so, specify what kind of growth (in what sectors) would most help the poor.
- Include measures that the government could take to reduce poverty in your country as well as in the African continent.
- If possible, specify where resources would come from.
- What is your timetable?

- Are there major points of disagreement within your group? Please put them on your list but mark with an X to signify non-agreement.

3. Ask each group to report back (15 min)

4. Ask participants to return to original groups and decide which points from the other group you would incorporate. Would it change any parts of your proposal? Are there points that you would argue against?

5. Final report backs and plenary discussion. Is there enough common ground to move forward? (15 min)



Facilitator's notes

The World Bank has incorporated concerns about poverty, democracy and participation and is requiring governments of developing countries to engage their citizens in the development of Poverty Reduction Strategies. While laudable in principle, in reality it is a very great challenge in terms of resources, communication, cultural/ethnic divisions, trust, and eliciting participation. Indeed, it would be a great challenge even for rich countries with lots of resources and long histories of civic participation.

Even if a country is able to involve its citizenry in developing such a strategy, there is no guarantee that they will be able to implement policies that go against international policies, such as those set by the 'quad' (US, EU, Canada, Japan) dominated WTO. Thus, the demand for democracy at the national level is at odds with the lack of democracy at the international level. Participants will probably be able to address poverty reduction strategies in their country, but may be less able to come up with measures to reduce poverty in Africa. Here are some suggestions:

- Ensuring that international human rights agreements are not over-ridden by economic agreements.
- Ending double standards between global north and south.
- Curbing financial speculation through currency transaction tax, capital controls.
- Capacity building to enable participation in poverty reduction planning and implementation.
- There is an increasing emphasis on democracy and human rights. However, human rights need to be broadened from civil-political rights (parties should desist from certain negative actions such as torture) to economic and social rights.

The ILO highlights four overarching areas in need of more concentrated attention towards the formulation of poverty strategies:

- Equity as a fundamental principle for ensuring that economic growth benefits the greatest number of people and reduces poverty. Fair and effective fiscal policies are one crucial requirement for this.
- A more thorough analysis of employment and other aspects of decent work, which give rise to the inclusion of fundamental principles and rights at work and social protection.
- Systematic integration of labour ministries, employers' and workers' organizations to strengthen national ownership and consideration of decent work.
- Strengthened partnership and dialogue with the UN system, the IFIs and bilateral partners at the country level for developing coherent responses.

3.7 Open economy: International trade and finance

“The propensity to truck, barter and exchange one thing for another is common to all men, and to be found in no other race of animals.”

*Adam Smith,
Scottish moral
philosopher and
a pioneering
political
economist
(1723-1790)*



Daily Nation, 7 July 2004, <http://www.gadonet.com>

(a) Economic models of an open economy

An open economy is an economy in which people, including businesses, can trade in goods and services with other people and businesses in the international community at large. This contrasts with a closed economy in which international trade cannot take place.

The act of selling goods or services to a foreign country is called exporting. The act of buying goods or services from a foreign country is called importing. Together, exporting and importing are collectively called international trade.

There are a number of advantages for citizens of a country with an open economy. One primary advantage is that the consumers have a much larger variety of goods and services from which to choose from. They also have an opportunity to invest their savings outside the country.

In an open economy, a country's spending in any given year need not equal its output of goods and services. A country can spend more money than it produces by borrowing from abroad, or it can spend less than it produces and lend the difference to foreigners.

The basic model

The basic economic model of an open economy is the same as that of a closed economy except that two new terms are added: Exports (EX) and Imports (IM):

$$Y = C^d + I^d + G^d + EX$$
$$Y = C + D + G + (EX - IM)$$

With Y being Gross Domestic Product, C^d is consumer consumption of domestic goods and services, I^d is investment in domestic goods and services, G^d is government expenditures on domestic goods and services.

Balance of payments

In economics, balance of payments (or BOP) measures the payments that flow between any individual country and all other countries. It is used to summarize all international economic transactions for that country during a specific time period, usually a year. The BOP is determined by the country's exports and imports of goods, services, and financial capital, as well as financial transfers. It reflects all payments and liabilities to foreigners (debits) and all payments and obligations received from foreigners (credits). Balance of payment is one of the major indicators of a country's status in international trade.

The balance, like other accounting statements, is prepared in a single currency, usually the domestic. Foreign assets and flows are valued at the exchange rate of the time of transaction.

The balance of payments for a country is the sum of the current account, the capital account, and the financial account.

Current account

The current account is the net change in current assets from trade in goods and services (balance of trade), net factor income (such as dividends and interest payments from abroad), and net unilateral transfers from abroad (such as foreign aid, grants and gifts).

Current account = balance of trade + net factor income from abroad
+ net unilateral transfers from abroad

Income account

The income account accounts mostly for investment income from dividends and interest on credit and payments on foreign taxes.

Unilateral transfers

Unilateral transfers are usually conducted between private parties. For example, Zimbabwe has a large surplus of remittances from South Africa and United Kingdom sent by emigrant workers. India has the world's largest surplus of remittances.

Capital account

The capital account records the international flows of transfer payments relating to capital items. Examples of such goods could be factories or heavy machinery transferred to or from abroad and so on.

Financial account

The financial account is the net change in foreign ownership of investment assets. The accounting entries in the financial account record the purchase and sale of domestic and foreign investment assets. These assets are divided into categories such as foreign direct investment (FDI), portfolio investment (which includes trade in stocks and bonds), and other investment (which includes transactions in currency and bank deposits).

If foreign ownership of domestic financial assets has increased more quickly than domestic ownership of foreign assets in a given year, then the domestic country has a financial account surplus. On the other hand, if domestic ownership of foreign financial assets has increased more quickly than foreign ownership of domestic assets, then the domestic country has a financial account deficit.

Official reserves

The official reserves account records the change in stock of reserve assets (also known as foreign exchange reserves) at the country's monetary authority. Frequently, this is the responsibility of a government-established Central Bank.

Net errors and omissions

This is the last component of the balance of payments and principally exists to correct any possible errors made in accounting for the three other accounts. These errors are likely to occur due to the complexity of the calculations and difficulty in obtaining measurements.

Omissions are used by governments to conceal transactions. They are often referred to as "balancing items".

The balance of payments identity states that:

Current Account = Capital account + Financial account + Net errors and omissions

This is a convention of double entry accounting, where all debit entries must be booked along with corresponding credit entries such that the net of the current account will have a corresponding net of the capital and financial accounts:

$$X + K_i = M + K_o$$

where:

X = exports

K_i = capital inflows

M = imports

K_o = capital outflows

Rearranging, we have:

$$(X - M) = K_o - K_i,$$

Thus yielding the BOP identity.

The basic principle behind the identity is that a country can only consume more than it can produce (a current account deficit) if it is supplied capital from abroad (a capital account surplus).

(b) International trade

International trade is the exchange of capital, goods and services across international boundaries or territories. In most countries, it represents a significant share of 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. Industrialization, advanced transportation, globalization, multinational corporations, and outsourcing are all having a major impact on the international trade system. Increasing international trade is crucial to the continuance of globalization. International trade is a major source of economic revenue for any nation that is considered a world power. Without international trade, nations would be limited to the goods and services produced within their own borders.



Definitions of some international trade terms

Tariff: is a tax or a fee that the government charges on goods crossing their borders. An import tariff is a tax or fee on all imported goods.

Non-trade barriers (NTB): are policies that the government imposes on imports. Unlike tariffs, which are monetary-based, NTBs are non-monetary. Examples include: (i) quotas where the governments puts a limit on goods that may be brought into a country or; (ii) rules about the types of goods that may or may not enter a country.

Trade surplus: is when exports exceed imports.

Trade deficit: is a situation where imports are greater than exports.

International trade is, in principle, not different from domestic trade as the motivation and the behaviour of parties involved in trade does not change fundamentally depending on whether trade is across a border or not. The main difference is that international trade is typically more costly than domestic trade. The reason is that a border typically imposes additional costs such as tariffs, time costs due to border delays and costs associated with country differences such as language, the legal system or a different culture.

Another difference between domestic and international trade is that 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 trade in capital, labour or other factors of production. Trade in goods and services can then serve as a substitute for trade in factors of production. Instead of importing the factor of production, a country can import goods that make intensive use of the factor of production and are thus embodying the respective factor. An example is the import of labour-intensive goods by the United States from China. Instead of importing Chinese labour, the United States is importing goods from China that are produced with Chinese labour.

Origins of international trade

The desire to trade is not only one of the oldest human instincts but also the cause of many of the most important developments in our shared history. Bernstein (2008) shows how trade evolved and shaped the world. His story begins with Sumerian farmers who realized, sometime in the 3rd millennium BC, that surpluses of maize grown within Mesopotamia's fertile crescent could be used as barter for things they did not have. Among these was copper, obtained from Sinai (several hundred miles to the west) that could be used to make weapons to repel the nomadic raiders who were otherwise helping themselves to the fruits of Sumerian labour.

Regulation of international trade

Traditionally, trade was regulated through bilateral treaties between two nations. For centuries, under the belief in Mercantilism, most nations had high tariffs and many restrictions on international trade. In the 19th century, especially in the United Kingdom, a belief in free trade became paramount. This belief became the dominant thinking among western nations since then, despite the acknowledgement that adoption of the policy coincided with the general decline of Great Britain. In the years since the Second World War, controversial multilateral treaties such as the General Agreement on Tariffs and Trade (GATT) and World Trade Organization have attempted to create a globally-regulated trade structure. These trade agreements have often resulted in protest and discontent, with claims of unfair trade that is not mutually beneficial.

Free trade is usually most strongly supported by the most economically powerful nations, though they often engage in selective protectionism for those industries that are strategically important, such as the protective tariffs applied to agriculture by the United States and Europe. The Netherlands

and the United Kingdom were both strong advocates of free trade when they were economically dominant. Today, the United States, the United Kingdom, Australia and Japan are its greatest proponents. However, many other countries (such as India, China and Russia) are increasingly becoming advocates of free trade as they become more economically powerful themselves. As tariff levels fall, there is also an increasing willingness to negotiate non-tariff measures, including foreign direct investment, procurement and trade facilitation. The latter looks at the transaction cost associated with meeting trade and customs procedures.

Traditionally, agricultural interests are usually in favour of free trade while manufacturing sectors often support protectionism. This has changed somewhat in recent years. In fact, agricultural lobbies, particularly in the United States, Europe and Japan, are chiefly responsible for particular rules in the major international trade treaties that allow for more protectionist measures in agriculture than for most other goods and services.

During recessions, there is often strong domestic pressure to increase tariffs to protect domestic industries. This occurred around the world during the Great Depression. Many economists have attempted to portray tariffs as the underlining reason behind the collapse in world trade that many believe seriously deepened the depression.

The regulation of international trade is done through the World Trade Organization at the global level, and through several other regional arrangements such as MERCOSUR in South America, the North American Free Trade Agreement (NAFTA) between the United States, Canada and Mexico, and the European Union between 27 independent states. The 2005 Buenos Aires talks on the planned establishment of the Free Trade Area of the Americas (FTAA) failed largely due to opposition from the populations of Latin American nations. Similar agreements such as the Multilateral Agreement on Investment (MAI) have also failed in recent years.

Risks in international trade

The risks that exist in international trade can be divided into two major categories:

Economic risks

- Risk of insolvency of the buyer
- Risk of protracted default—the failure of the buyer to pay the amount due within six months after the due date
- Risk of non-acceptance
- Surrendering economic sovereignty
- Risk of exchange rate

Political risks

- Risk of cancellation or non-renewal of export or import licences
- War risks
- Risk of expropriation or confiscation of the importer's company
- Risk of the imposition of an import ban after the shipment of the goods
- Transfer risk—imposition of exchange controls by the importer's country or foreign currency shortages
- Surrendering political sovereignty
- Influence of political parties in importer's company

Pitfalls of free trade

It very much matters what a country specializes in. Some paths of development pay better and are more stable than others. Production of primary goods such as agricultural or mineral extraction is a particularly dodgy proposition given the wild swings in prices. Agricultural specialization runs the additional risk of getting wiped out by poor weather or disease (e.g. the Potato Famine). Examples:

- In the late 1990s, a Nicaraguan agricultural cooperative invested heavily in switching production from corn to onions for export to Honduras. They were not able to get the onions across the border, however, and suffered a severe loss.
- In Zambia, copper accounted for 95 per cent of exports and more than half of state revenue in the mid-1970s. The economy grew at about 6 per cent a year from 1964 to 1974, but then the price of copper collapsed from about \$1.00 to \$.50 per pound. The economy experienced negative growth for the next decade. Zambia has yet to recover.
- Unemployed workers in “sunset industries” (meaning industries in decline) cannot just pick up and move. They do not necessarily know where the new jobs are, and they might not have the necessary skills. Capitalists of sunset industry may decide to set up production in another country leading to more unemployment and a slump in the national economy.
- Developing countries cannot industrialize if they are forced to compete against the advanced industrial countries within the framework of “free trade.” The industrial leaders of the world did not get there by specializing in the areas in which they had a comparative advantage. If this were the case, then the US would have remained an agricultural economy. No, the US, just like Britain, Japan and every other industrialized country got there by protecting its infant industries from their more advanced competitors.

(c) Contemporary trade policies

There are many ways of controlling and promoting international trade today. The methods range from agreements among governments—whether bilateral or multilateral—to more ambitious attempts at economic integration through supranational organizations, such as the European Union (EU).

What are trade liberalization policies?

1) Reduction of protectionist tariffs and quotas

Countries use protectionism such as tariffs and quotas to protect industries and jobs from competition. Forms of protectionism include:

- Import tariffs—taxes placed on imports
- Quotas—quantitative limits on imports

2) Elimination of non-tariff barriers to trade

Non-tariff barriers to trade mean anything that, critics argue, gives an 'unfair advantage' to local industries. For example:

- Subsidies to domestic industries or agriculture
- A wide range of policies enacted by countries to protect their citizens, the environment, human rights, that have the effect of restricting imports that do not meet these standards

3) Elimination of restrictions or requirements on foreign investment

This is meant to make it easier for industry and financial capital to move around the globe by phasing out capital controls and other regulations. Capital controls are various ways of controlling the inflow or outflow of capital. For example:

- Controlling the outflow of capital by limiting the ability of a multinational corporation to move production abroad (e.g. payment of compensation, 'exit' taxes, a lengthy notification requirement, limits on foreign currency exchange, among others).
- Controlling the inflow of capital, for instance, by requiring a certain per cent of local ownership in foreign enterprises, or sourcing inputs locally.

4) TRIPS (Trade-Related Intellectual Property Rights)

Strengthens the hand of patent holders. The life of patents has been extended to 20 years.

Trade agreements

The term trade agreement or commercial agreement can be used to describe any contractual arrangement between states concerning their trade relationships. Trade agreements may be bilateral or multilateral—that is, between two states or between more than two states.

Bilateral trade agreements

A bilateral trade agreement usually includes a broad range of provisions regulating the conditions of trade between the contracting parties. These include stipulations governing customs duties and other levies on imports and exports, commercial and fiscal regulations, transit arrangements for merchandise, customs valuation bases, administrative formalities, quotas, and various legal provisions. Most bilateral trade agreements, either explicitly or implicitly, provide for: (i) reciprocity; (ii) most-favoured-nation treatment; and (iii) “national treatment” of non-tariff restrictions on trade.

Reciprocity

In a trade agreement, the parties make reciprocal concessions to put their trade relationships on a basis deemed equitable by each. The principle of reciprocity is extremely old, and in one form or another it is to be found, implicitly at least, in all trade agreements. The concessions may, however, be in different areas. In the Anglo-French Agreement of 1860, for example, France pledged itself to reduce its duties to 20 per cent by 1864. In return, Britain granted duty-free imports of all French products except flowers and spirits. The principle of reciprocity implies only that the gains arising out of foreign trade are distributed fairly.

The most-favoured-nation clause

The most-favoured-nation (MFN) clause binds a country to apply to its partner country any lower rate of import duties that it may later grant to imports from some other country. The clause may cover a list of specified products only, or specific concessions yielded to certain foreign countries. Alternatively, it may cover all advantages, privileges, immunities, or other favourable treatment granted to any third country. The clause is intended to provide each signatory with the assurance that the advantages obtained will not be attenuated or wiped out by a subsequent agreement concluded between one of the partners and a third country. It guarantees the parties against discriminatory treatment in favour of a competitor.

The effect of the MFN clause on customs duties is to amalgamate the successive trade agreements concluded by a state. If the rates in different agreements are fixed at varying levels, the clause reduces them to the lowest rate specified in any agreement. Thus, goods imported from a country benefiting from MFN treatment are charged the rate of duty applicable to imports from another country which, in a subsequent trade agreement, has negotiated a lower rate of duty.

The coverage of the MFN clause can be considerably reduced by a minute definition of a particular item so that a concession, while general in form, applies in practice to only one country. A historical illustration of this technique can be found in the German Tariff of 1902, which admitted at a special rate large dappled mountain cattle, reared at a spot at least 300 metres above sea level, and which have at least one month's grazing each year at a spot at least 800 metres above sea level.

The advantages granted under the MFN clause may be conditional or unconditional. If unconditional, the clause operates automatically whenever appropriate circumstances arise. The country drawing benefit from it is not called on to make any fresh concession. By contrast, the partner invoking a conditional MFN clause must make concessions equivalent to those extended by the third country. A typical wording was that of the 1911 treaty between the United States and Japan, which stated that in all that concerns commerce and navigation, any privilege, favour or immunity...to the citizens or subjects of any other state shall be extended to the citizens or subjects of the other contracting party gratuitously, if the concession in favour of that other state shall have been gratuitous, and on the same or equivalent conditions if the concession shall have been conditional.

The conditional form of the clause may at first sight seem more equitable. However, it has a major drawback of being liable to raise a dispute each time it is invoked, for it is by no means easy for a country to evaluate the compensation it is being offered as in fact being equivalent to the concession made by the third country.

The effect of the unconditional form of the MFN clause is, finally, to wipe out any relevance that the principle of reciprocity may have had to the purely bilateral preoccupations of the negotiating parties, since the results of the bargaining process, instead of being limited to the participants, influence their relationships with other states. In practice, therefore, a country negotiating a trade agreement must measure the advantages it is willing to concede in terms of the benefits these concessions will provide collaterally to that third country, which is the most competitive. In other words, the concessions that may be granted are determined by the minimum protection that the negotiating state deems indispensable to protect its home producers. This sets a major limitation on the scope of bilateral negotiations.

Proponents of free trade consider that the unconditional MFN clause is the only practical way by which to obtain the progressive reduction of customs duties. Those who favour protectionism are resolutely against it, preferring the conditional form of the clause or some equivalent mechanism.

The conditional MFN clause was generally in use in Europe until 1860 when the so-called Cobden-Chevalier Treaty between Great Britain and France established the unconditional form as the pattern for most European treaties. The United States used the conditional MFN clause from its first

trade agreement, signed with France in 1778, until the passage of the Tariff Act of 1922, which terminated the practice.

The Conference of Genoa, Italy, in May 1922 and the World Economic Conference in May 1927 both recommended that trade agreements include the MFN clause whenever possible. However, the Great Depression of the 1930s led, instead, to a rise of restrictions in world trade. Imperial or regional systems of preference came into being: the Ottawa Agreements of 1932 for the British Commonwealth, similar arrangements for the French empire, and a series of tariff and preference agreements negotiated in eastern and central Europe from 1931 on.

The “national treatment” clause

The “national treatment” clause in trade agreements was designed to ensure that internal fiscal or administrative regulations would not introduce discrimination of a non-tariff nature. It forbids discriminatory use of the following: taxes or other internal levies; laws, regulations, and decrees affecting the sale, offer for sale, purchase, transport, distribution, or use of products on the domestic market; valuation of products for purposes of assessment of duty; legislation on prices of imported goods; warehousing and transit regulations; and the organization and operation of state trading corporations.

Multilateral agreements after World War II

The conclusion of World War II spurred efforts to correct the problems stemming from protectionism, which had increased since 1871, and trade restrictions, which had been imposed between World Wars I and II. The resulting multilateral trade agreements and other forms of international economic cooperation led to the General Agreement on Tariffs and Trade (GATT) and laid the foundation for the World Trade Organization (WTO).

General Agreement on Tariffs and Trade

The General Agreement on Tariffs and Trade was signed in Geneva on 30 October 1947 by 23 countries, which accounted for four-fifths of world trade. On the same day 10 of these countries, including the United States, the United Kingdom, France, Belgium, and The Netherlands signed a protocol bringing the agreement into force on 1 January 1948.

GATT took the form of a multilateral trade agreement that set forth the principles under which the signatories, on a basis of “reciprocity and mutual advantage,” would negotiate “a substantial reduction in customs tariffs and other impediments to trade, and the elimination of discriminatory practices in international trade.” As more countries joined, GATT became a charter governing almost all world trade except for that of the communist countries.

The agreement also contained a variety of clauses providing exceptions to the rules in special situations. These included balance-of-payments

disequilibrium; serious and unexpected damage to domestic production; the requirements of economic development or, subject to very broad reservations, of agricultural policy; the need to protect domestic raw material production; and the interests of national security. In addition, GATT rules permitted various departures from the MFN principle. For example, within the former European Economic Commission (EEC), France could permit duty-free entry of goods from its fellow members—such as Germany and Italy—without extending such duty-free treatment to the products of non-EEC nations.

Prior to the creation of GATT's successor organization, the WTO, multilateral trade conferences, called rounds, were held periodically by GATT countries to resolve trade problems. Most of these took place in Geneva, former site of GATT headquarters and current site of the WTO. At the time, the formula for multilateral tariff bargaining under GATT represented a major innovation in inter-governmental cooperation. In appraising the concessions that they could afford to make, this approach to GATT negotiations permitted governments to account for the indirect advantages that they could expect from the full set of bilateral negotiations. GATT made positive contributions to the growth of world trade, with three GATT sessions seen as having particular historic importance—the so-called Kennedy, Tokyo, and Uruguay Rounds.

As the economic integration of western Europe progressed, some Americans became concerned at the prospect of being excluded from these advances in trade policy. President John F. Kennedy pursued the goal of an Atlantic partnership and secured special negotiating powers under the Trade Expansion Act of 1962. The Act authorized tariff reductions of up to 50 per cent, subject to reciprocal concessions from the European partners. This marked a fundamental shift from the traditional protectionist posture of the United States and led to the Kennedy Round negotiations in GATT, held in Geneva from May 1964 to June 1967.

The Kennedy Round continued the process of tariff reduction that industrial countries had begun two decades earlier. While developing countries drew little immediate advantage from the Kennedy Round negotiations, they were able to obtain the addition of a new part titled "Trade and Development" to the GATT charter, calling for stabilization, as far as possible, of raw material prices; reduction or abolition of customs duties or other restrictions that differentiate unreasonably between products in their primary state and the same products in finished form; and renunciation by the advanced countries of the principle of reciprocity in their relations with less-developed countries.

The next ministerial meeting of GATT opened in Tokyo on 12 September 1973, and was attended by representatives of ministerial or comparable level from 102 countries. On 14 September the meeting closed with the adoption of what came to be called the Tokyo Declaration.

The Tokyo Declaration differed markedly from previous GATT documents in the inordinately large portion of its language devoted to strengthening the negotiating position of the less-developed countries. Specifically, the

trade negotiations would aim at improving the conditions of access for products of interest to such countries while ensuring stable, equitable, and remunerative prices for primary products. Tropical products would be given special and priority treatment. The principle of non-reciprocity in negotiations between developed and less-developed countries, an established principle in GATT, was reaffirmed. The importance of maintaining and improving the Generalized System of Preferences (a provision for lower tariff rates) granted by developed countries to less-developed countries, as well as the need for special measures and the importance of providing special, differential, and more favourable treatment for less-developed countries, were recognized. Special attention was to be given to the trade interests of the least-developed countries.

The Tokyo Declaration was followed by several years of multinational trade negotiations that came to be called the Tokyo Round, concluding in 1979 with the adoption of a series of tariff reductions to be implemented generally over an eight-year period beginning in 1980. Further progress was also made in dealing with non-tariff issues. Most notably, a Code on Subsidies and Countervailing Duties was negotiated. This code had two main features: it listed a number of unacceptable subsidy practices, and it introduced a requirement that formal procedures be followed before the imposition of countervailing duties on imports subsidized by foreign nations. Specifically, before the imposition of a countervailing duty, an investigation had to establish that competing domestic firms were being injured. The code was not signed by all of the members, however, and the signing nations agreed only to follow the prescribed rules before applying countervailing duties to the exports of other signatories. Thus, while the code represented progress in dealing with a new topic, it also represented a departure from the MFN principle; signatories were not required to extend the benefits of the code to GATT members who did not sign the code.

A new set of negotiations was initiated at a conference in Uruguay in 1986. Because traditional tariffs were becoming much less important, most of the attention was focused on other impediments to international transactions, such as those affecting trade in services or intellectual property. The Uruguay Round led to the replacement of GATT by the WTO in 1995. Whereas GATT focused almost exclusively on goods (though much of agriculture and textiles were excluded), the WTO encompassed all goods, services, and intellectual property, as well as some investment policies. The combined share of international trade of WTO members came to exceed 90 per cent of the global total.

Multi Fibre Arrangement

The Multi Fibre Arrangement (MFA), also known as the Agreement on Textile and Clothing (ATC), governed the world trade in textiles and garments from 1974 through 2004, imposing quotas on the amount developing countries could export to developed countries. It expired on 1 January 2005.

The MFA was introduced as a short-term measure intended to allow developed countries to adjust to imports from the developing world. Developing countries have a natural advantage in textile production because it is labour intensive and they have low labour costs. According to a World Bank and the International Monetary Fund (IMF) study, the system has cost the developing world 27 million jobs and \$40 billion a year in lost exports. However, the Arrangement was not negative for all developing countries. For example, the European Union (EU) imposed no restrictions or duties on imports from the very poorest countries, such as Bangladesh, leading to a massive expansion of the industry there.

At the GATT Uruguay Round, it was decided to bring textile trade under the jurisdiction of the World Trade Organization. The Agreement on Textiles and Clothing provided for the gradual dismantling of the quotas that existed under the MFA. Although this process was completed on 1 January 2005, large tariffs remain in place on many textile products.

World Trade Organization

As the successor to the General Agreement on Tariffs and Trade (GATT), the World Trade Organization (WTO) was established to supervise and liberalize world trade.

During negotiations ending in 1994, the original GATT and all changes to it introduced prior to the Uruguay Round of trade negotiations were renamed GATT 1947. This earlier set of agreements was distinguished from GATT 1994, which comprises the modifications and clarifications negotiated during the Uruguay Round (referred to as “Understandings”) plus a dozen other multilateral agreements on merchandise trade. GATT 1994 became an integral part of the agreement that established the WTO. Other core components include the General Agreement on Trade in Services (GATS), which attempted to supervise and liberalize trade; the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which sought to improve protection of intellectual property across borders; the Understanding on Rules and Procedures Governing the Settlement of Disputes, which established rules for resolving conflicts between members; the Trade Policy Review Mechanism, which documented national trade policies and assessed their conformity with WTO rules; and four plurilateral agreements, signed by only a subset of the WTO membership, on civil aircraft, government procurement, dairy products, and bovine meat (though the last two were terminated at the end of 1997 with the creation of related WTO committees). These agreements were signed in Marrakech, Morocco, in April 1994 and, following their ratification, the contracting parties to the GATT treaty became charter members of the WTO. By the early 21st century, the WTO had more than 145 members.

Critics of the WTO, including many opponents of economic globalization, have charged that the organization undermines national sovereignty by promoting the interests of large multinational corporations and that the trade liberalization it encourages leads to environmental damage and declining living standards for low-skilled workers in developing countries. Some WTO members, especially developing countries, resisted attempts

to adopt rules that would allow for sanctions against countries that failed to meet strict environmental and labour standards, arguing that the sanctions would amount to veiled protectionism. Despite these criticisms, however, WTO admission remained attractive for non-members, as evidenced by the increase in membership after 1995. Most significantly, China entered the WTO in 2001 after years of accession negotiations, and many other countries were slated to join through accession in succeeding years.

ITUC versus WTO: Serious jobs impact in developing countries

The International Trade Union Confederation (ITUC)¹ has expressed deep concerns on the pressure on developing countries to make disproportionate commitments, in particular in the “NAMA” (non-agricultural market access) negotiations on manufactured goods. Developing countries are being pressured into giving up industrial potential, in stark contrast to the protections that would be kept by developed-country agriculture.

Millions of workers face the risk of losing their jobs, with grave consequences for their families and for the economic future of their countries. Trade unionists from the “NAMA 11” group of developing countries that stand to be particularly affected by the negotiations (currently comprising Argentina, Brazil, Venezuela, Egypt, India, Indonesia, Namibia, Tunisia, Philippines and South Africa), and from other developing countries, are in Geneva this week to lobby against a deal that threatens their members’ jobs and their countries’ development.

The ITUC is particularly alarmed at the newly proposed anti-concentration clause, which would further restrict the way in which developing countries can use their “flexibilities” to exempt certain sensitive industries, which were already inadequate. Further restricting them could create serious difficulties for the capacity of developing countries to protect their industries, employment and the policy space for future industrial development, in total contradiction to the aspirations of a “development round”. This would add pressure for low-wage competition between developing countries, with negative impacts on fundamental labour and environmental standards.

ITUC projections show that the current proposals are likely to impact hardest in the textiles sector, and also have effects across a wide range of manufacturing employment. As many as 650,000 workers are employed in sectors facing tariff

¹ The ITUC represents 168 million workers in 155 countries and territories and has 311 national affiliates.

cuts in South Africa, with some 500,000 each in India and Indonesia.

Based on the coefficients that are being proposed, applied tariff rates in South Africa would be cut by between 30 per cent and 60 per cent, causing problems for the workers in sectors such as textiles and clothing, leather, footwear, plastic, rubber, wood, automobile, chemicals, machinery, furniture and metals. In Argentina and Brazil, the picture is the same, as the proposed coefficients would lead to real tariff cuts of between 20 per cent and 50 per cent. Metals, furniture, automobiles, textiles, clothing, leather and footwear would be particularly affected, with the potential for the loss of over 1.2 million formal jobs in Brazil and over 150,000 in Argentina.

In Indonesia, the Philippines and India, it would mainly be clothing and automobile and transport equipment that would bear the brunt of tariff cuts, with over half a million formal jobs at risk in India and Indonesia and some 400,000 in the Philippines. Tunisia, with direct tariff cuts of between 30 per cent and 70 per cent in sectors such as textiles, clothing, leather, footwear, metals, rubber, wood and automobiles could have 150,000 workers affected.

Even countries that are not part of the NAMA 11 group would face difficulties, and trade unionists from these countries too are concerned about the proposals on the table, which could lead to job losses and also future developmental constraints. These countries include, for example, Mexico, Peru, Colombia, Costa Rica and Chile. In particular, Mexico, Colombia and Peru could face some direct impacts, with 135,000 jobs concerned in Colombia, over 100,000 in Peru and 1.5 million in Mexico.

Source: Brussels, 24 July 2008 (ITUC OnLine): Website: <http://www.ituc-csi.org>

Economic (or regional) integration

At the outset, it is useful to distinguish four major concepts that are at times used interchangeably: regionalism, regional integration, regional co-operation and economic integration.

“Regionalism” represents a regional approach to problem solving, including regional integration, regional cooperation or both. The terms “regional integration” and “regional cooperation” have in common the involvement of neighbouring countries in collaborative ventures. However, regional cooperation implies that this is organized on an ad hoc and temporary basis through contractual arrangements of some sort, around projects of mutual interest.



Daily Nation, 22 June 2002. <http://www.gadonet.com>

The economic integration of several countries or states may take a variety of forms. The term covers preferential tariffs, free trade associations, customs unions, common markets, economic unions, and full economic integration. The parties to a system of preferential tariffs levy lower rates of duty on imports from one another than they do on imports from third countries. For example, Great Britain and its Commonwealth countries operated a system of reciprocal tariff preferences after 1919.

In free trade associations, no duty is levied on imports from other member states, but different rates of duty may be charged by each member on its imports from the rest of the world. A further stage is the customs union, in which free trade among the members is sheltered behind a unified schedule of customs duties charged on imports from the rest of the world. The 19th-century German Zollverein was a customs union.

A common market is an extension of the customs union concept, with the additional feature that it provides for the free movement of labour and capital among the members. An example was the Benelux Common market, until it was converted into an economic union in 1959. The term economic union denotes a common market in which members agree to harmonize their economic policies generally, as is the case with the European Union.

Finally, total economic integration implies the pursuit of a common economic policy by the political units involved. Examples are the states of the United States or the cantons of the Swiss Confederation.

Economic integration may be brought about by the political will of a state powerful enough to impose it, as under the Roman Empire or the European colonial systems of the 19th century, or it may result from freely negotiated agreement between sovereign states, as was more common in the 20th century.

The attempts at economic integration made after World War II can be appraised only by reviewing them against the background of the long process through which, over the centuries, the nations of the world have progressively achieved economic integration. Thus, for instance, the world's greatest power in the 17th century, France, was divided into a number of provinces separated from one another by various customs barriers involving a multitude of duties, tolls, and prohibitions. Trade regulations and fiscal charges differed from one region to the next; there was not even a single system of weights and measures. Not until after the Revolution did the economic integration of France really get under way.



Activity

Here are some approaches to challenging neo-liberalism and trade liberalization. Assess and critique. Are there other approaches that are preferable?

- Anti-globalization protests
- Drop the debt campaigns
- Lobbying EU to level the playing field with respect to agricultural subsidies, protectionism and dumping
- Working with NGOs to reform WTO
- Working to change domestic neo-liberal and free trade economic strategy

Economic integration in Africa

There is a long history of regional integration arrangements in Africa, beginning with the customs unions in 1900 between Kenya (then East African Protectorate) and Uganda.

Pan-African level

There are broadly two kinds of regional groupings in Africa, namely, those sponsored by the United Nations Economic Commission for Africa (UNECA) and those resulting from other initiatives. UNECA has promoted three sub-regional arrangements: Economic Community for West African States (ECOWAS), the Common Market for Eastern and Southern Africa (COMESA), and the Economic Commission for Central African States (ECCAS).

The treaty establishing the African Economic Community agreed upon in Abuja in 1991 may be seen as the culmination of past declaration of African heads of state and governments and their ministers (for example, the Kinshasa Declaration of 1976, and the Lagos Plan of Action and the Final Act of Lagos of 1980 regarding their desire to create an Africa-wide economic community).

The objectives of the African Economic Community (AEC) are to:

- promote economic, social, and cultural development and integration of African economies to increase self-reliance and promote self-sustained development,
- develop a continent-wide framework for the development and utilization of human and material resources,
- achieve economic stability and peaceful relations among member states through co-operation, and
- co-ordinate and harmonize policies between existing and future economic communities as a means of establishing a continental community.

The treaty establishing the African Economic Community and the Constitutive Act of the African Union emphasizes the imperative need for economic cooperation and regional integration. It is also understood that such a Community or African Union would be established and be supported by regional economic communities or groupings such as ECOWAS, AMU, ECCAS, COMESA, SADC, EAC and IGAD, which are the pillars on which the AEC Community or Union would stand when eventually established. The advantages of such regional cooperation and integration would lead to greater economies of and returns to scale and ensure the creation and expansion of wider markets and expansion of employment opportunities. In view of the fact the community or union is and must not be the preserve of African governments, but be for and owned by the people, it follows that the people, civil society and other peoples' organizations such as NGOs, trade unions, employers organizations, women and youth organizations, chambers of commerce and industry, private sector organizations, manufacturers and other associations as stakeholders and beneficiaries should also be closely involved in the functioning of the African Union.

In addition to the foregoing advantages, the promotion and strengthening of regional and sub-regional economic cooperation and integration, particularly in research, higher-education and training; exchange of information, experience and expertise; mutual assistance in cases of cross-border disasters and diseases/epidemics (e.g. floods, animal diseases, HIV/AIDS) development of joint ventures, centres of excellence should be stepped up in accordance with the principle of comparative advantage.

Despite the existence of these regional groupings, the African region is beset by weak cross-border economic links. Numerous problems have continued to impede the progress of regional integration in Africa:

- The production structures of most African countries are the same and hence exportable products tend to be competitive rather than complementary

- Inadequate transport and communication have partly contributed to the lack of cohesiveness of African economies and severely restricted the movement of goods, persons and capital
- Lack of currency convertibility
- The continued existence of tariff and non-tariff barriers
- Fear of losing out to more developed member state(s) of sub-regional groupings
- Differences among political leaders

There are numerous attempts of integration efforts in Africa. These take a number of forms but are mainly manifested by the existence of inter-governmental organizations (IGOs). Some of these bring together as few as two countries (e.g. Senegambia) to pan-African organizations joining 53 countries as in the case of the African Union (AU). Yet, the bitter truth is that there are no obvious successes.

Role of unions in economic integration of Africa

There is almost a one-to-one transposition of trade unions alongside the creation of a regional integration process in Africa. In southern Africa, the Southern African Trade Union Coordination Council (SATUCC) was formed in March 1993 at its inaugural congress held in Gaborone, Botswana. With 12 affiliates, SATUCC campaigns for the development of strong, independent and self-reliant national trade union centres across the sub-region.

In November 1991, SATUCC adopted the Social Charter of Fundamental Rights of Workers in Southern Africa. The charter is a solemn declaration and lays down the broad principles of a model southern African labour law and, more generally, the place of the worker in society. In March 1992, the Southern African Labour Council (SALC), a tripartite structure, adopted the Social Charter.

In East Africa, the East African Trade Union Confederation (EATUC) is an umbrella organization bringing together the national trade union centres within the East Africa Community member states: Burundi, Kenya, Rwanda, Uganda and the United Republic of Tanzania. EATUC was established in 1988 with its broad objective being to integrate workers' interests and efforts in the East African region with a view to developing a common approach towards enhancing social and economic justice through the participation of workers' organizations at every level of regional integration.

The organization is also aiming to promote cooperation among workers in East Africa through joint development of workers' education programmes, research activities and integration of the gender dimension in trade union work. As a regional workers' body, EATUC is instrumental in ensuring that the East African Community involves labour in all issues regarding regional integration: institutes tripartism as a method of work; promotes

the ratification of international labour standards by the member states and the harmonization of labour laws and policies in East Africa; and encourages the concept of free movement of the factors of production in the region. In addition, EATUC has also adopted an extended list of objectives such as the elimination of hunger through food security, the creation of productive employment, and the promotion of conflict resolution in East Africa.

In West Africa, despite its revitalization in 1999, the Organization of Trade Unions of West Africa (OTUWA) currently has no major activities. In Central Africa, the sub-regional trade union body, Organization des travailleurs de l'Afrique centrale (OTAC), still has a long way to go.

In North Africa, the Union des syndicats des travailleurs du Maghreb arabe (USTMA) brings together trade union federations in the sub-region. On 1 May 1991, USTMA issued a Charter of Fundamental Social Rights of Workers in the Maghreb. The charter welcomed the creation of the AMU and emphasized the need to make social dimensions part of integration efforts. There is also the International Confederation of Arab Trade Unions (ICATU), which groups trade union centres from the Arab world.

Many countries in Africa, as indeed in other parts of the world, are taking more interest in regional economic integration and have instituted programmes towards fostering this cause. Workers' organizations, on their part, have not been left behind in supporting the emergence and strengthening of regional integration. In fact, trade unions are on record as calling for increased efforts by governments to bring about faster regional economic integration. Trade unions have been active partners in various activities of such economic and social interest groups.

What has been a concern to the trade union organization is the fact that the resulting regional integration agreements have mainly concentrated on capital and natural resource mobilization and have tended to ignore the critical role of human resource mobilization and other social aspects. Trade unions have reiterated that, for integration to be successful, the stakeholders, of whom workers and their organizations are a major component, must be involved in the design process, decision-making machineries and implementation of all programmes and projects. Social aspects such as poverty eradication, human and trade union rights, creation of decent employment, and observance of international labour standards should always be among the prominent priorities.

A further challenge to trade unions is the fact that modern industrial relations systems in most countries have primarily involved the national arena, with employment regulation rooted in agreements between national unions and employers' organizations, and legislation enacted by the national state.

Liberalization of international trade, the globalization of financial markets and the growing importance of multinational companies appear to threaten such nationally-based systems. The emergence of regional labour markets (the East African Community, for instance) implies that the key decisions affecting national labour markets are taken outside the country

concerned. Cross-national comparisons of labour costs affect national competitiveness and also shape corporate investment decisions; this constrains the conduct of national collective bargaining. The stability of national currencies seems to require that governments adopt deflationary economic policies, often against the interests of labour.

Pessimists argue that internationalization completely undermines the effectiveness of trade unions. More cautious analysts suggest that, at the very least, their room for manoeuvre has become much narrower than in the past. The implication is that unions must strengthen their own international organizations in response.

Consequently, trade unions are called to play a more active role in achieving a social dimension of globalization and regional integration. In addition to campaigning for their right to be consulted, they are instituting mechanisms to strengthen sub-regional workers' organizations through which they can present their views. The formulation of social charters of fundamental workers' rights and their incorporation and adoption by the respective regional groupings calls for a step towards ensuring that human and trade union rights are enshrined and respected.



Macroeconomics Quiz

1. It is impossible to have falling inflation and falling unemployment at the same time
 - ☐ True
 - ☐ False
2. The official measure of Gross Domestic Product understates the true level of national income because of the existence of the informal economy
 - ☐ True
 - ☐ False
3. Which one of the following is not a major macroeconomic objective of the government?
 - A. Low and stable inflation
 - B. A high level of employment
 - C. Sustainable economic growth
 - D. A fall in the price of crude oil
4. The money value of goods and services produced in a year within the geographical boundaries of a country is known as:
 - A. Balance of Payments
 - B. Gross Domestic Product
 - C. Per capital National Income
 - D. Gross National Product
5. In the commonly accepted definition of a recession, the level of national output
 - A. Rises at an accelerating rate
 - B. Rises at a decreasing rate
 - C. Is rising faster than the trend rate of national output
 - D. Falls

6. If national output in one year is measured at ZAR 300 billion and a year later it is measured at ZAR 315 billion, then the rate of growth in that year is

- A. 2 per cent
- B. 3 per cent
- C. 5 per cent
- D. 15 per cent

7. If prices and wages rise at the same per cent rate, the real purchasing power of the average worker will

- A. Rise or fall depending on what happens to the level of interest rates
- B. Stay the same
- C. Rise
- D. Fall

8. In terms of her gross domestic product (GDP), South Africa is the largest economy in the African continent

- ☐ True
- ☐ False

9. Which one of the following would best indicate economic growth? An index of

- A. Share prices
- B. Consumer spending
- C. Company profits
- D. Gross domestic product

10. A country cannot achieve a period of long term economic growth unless there is immigration of labour into an economy to boost the size of a country's labour force

- ☐ True
- ☐ False

Answers: 1. False; 2. True; 3. D; 4. B; 5. D; 6. C; 7. B; 8. True; 9. D; 10. False

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Further reading

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Unit 4: Economics of the labour market

“Labour is prior to, and independent of, capital. Capital is only the fruit of labour, and could never have existed if labour had not first existed. Labour is the superior of capital, and deserves much the higher consideration.”

Abraham Lincoln, American 16th US President (1861-65), who brought about the emancipation of slaves (1809-1865)

Labour is an integral part of the economy. What labour does affects the economy and what happens in the economy affects labour. These interactions form a theme that runs through this unit. Trade union settlements influence wages, incomes and the general standard of living. Macroeconomic policies, on the other hand, affect unemployment, which in turn influences the activities of labour. Labour and the economy form a whole, and must be looked at together. This is what this unit is about—a treatment of labour and the economy in its interactive forms—in theory, in policy, in practice and in institutional processes. Studying this unit will help you see how work, wages, and living standards combine to form a set of problems that challenge economists, trade unionists, employers and the nation at large.

Topics

1. Introduction

2. Labour and the micro economy

- Labour supply
- Labour demand
- Labour market equilibrium
- Labour market flexibility
- Labour unions and wage determination
- Trade unions as economic institutions
- Trade unions and wage determination

3. Labour and the macro economy

- Unemployment: Meaning and measurement
- Kinds of unemployment
- Tackling unemployment
- Full employment
- Informal and gender dimensions of employment
- Inflation: Meaning, measurement and causes

4. Labour and public policy

- Minimum wages legislation
- Social security, health and safety
- Labour migration

4.1 Introduction

“All wealth is
the product of
labour.”

*John Locke,
English
Philosopher
who made great
contributions in
studies of politics,
government
and psychology
(1632-1704)*

In playing football, Didier Drogba of Ivory Coast earns more in a weekend than a university professor earns in a month. An unskilled worker in the European Union earns more than an unskilled worker in Africa. Few economies in Africa provide jobs for all their citizens wanting to work. How can we explain these aspects of the real world? In each case, the answer depends on the supply and demand for the type of labour required. This reality makes the study of labour economics, which is a branch of economics that seeks to understand the functioning and dynamics of the market for labour, even closer to everyday realities of the world of work. This unit on economics of the labour market, therefore, looks at the suppliers of labour services (workers), the demanders of labour services (employers), and attempts to understand the resulting pattern of wages, employment and peoples' standards of living.

There are two ways of understanding the market for labour: microeconomic and macroeconomic approaches. The microeconomic approach focuses on the role of individuals, individual households and firms in the labour market. The macroeconomic approach looks at the inter-relations between the labour market and other markets, e.g. the goods market, the money market, and the foreign trade market, and understands how these interactions influence such aggregate variables as employment and national income. These two approaches guided how this unit is structured. Microeconomic issues are dealt with first and then macroeconomic issues follow thereafter. Trade unions as key economic institutions in the labour market are dealt with in the context of wage determination. The unit concludes with a treatment of some contemporary public policy issues that warrant separate treatment.

4.2 Labour and the micro economy

Labour supply

“Labour was
the first price,
the original
purchase—money
that was paid
for all things.
It was not by
gold or by silver,
but by labour,
that all wealth
of the world
was originally
purchased.”

*Adam Smith,
Scottish
philosopher and
economist
(1723-1790)
Labour supply*

Labour supply refers to the total number of hours that labour is willing and able to supply at a given wage rate. It can also be defined as the number of workers willing and able to work in a given occupation or industry for a given wage rate.

Labour supply involves three types of decisions made by households and individuals:

- How many hours of labour to offer to the labour market
- Whether to seek work at all
- How much human capital (what level of skills and training) the individual will bring to the labour market

Thus, labour supply can be viewed from at least three perspectives: how many hours people work once in the labour force, whether people join

the labour force at all and what quality of labour they bring to the labour market.



Definitions

The **labour force** is all individuals in work or seeking employment.

The **participation rate** is the fraction of the population of working age who join the labour force. Specifically, the labour force participation rate is the ratio of the number of labour force participants to the total eligible population.

Human capital is the sum total of investment made in a person's education, training and skills acquisition.

Elasticity of labour supply

Implicit in the decisions of how many hours an individual should supply at a wage rate is the concept of the elasticity of labour supply. The elasticity of labour supply measures the sensitivity of hours worked to changes in the wage rate. It reflects the change in hours worked that occurs in response to a change in the wage rate. More specifically, the elasticity of labour supply is measured by the per cent change in hours worked in relation to the per cent change in wages.

Knowing the elasticity of labour supply is important for evaluating certain policy proposals. For instance, there is a substantial interest today between people who are willing and able to work and the type of jobs available in an economy. In low-skilled occupations, it must be expected that labour supply will be elastic. This means that a pool of readily available labour would be employable at a fairly low wage rate. However, where jobs require specific skills and lengthy periods of training, labour supply will be more inelastic because it is hard to expand the workforce in a short period of time. Similarly, in many professional occupations, there are barriers to entry of new workers; examples include law, accountancy and medicine. The need for high level educational qualifications makes the supply of newly qualified entrants to these occupations quite inelastic in the short-run and is one reason why these workers may earn higher than average salaries.

Labour time supplied to the market by the household

Now, a household's decision to offer labour services to firms is part of its overall financial planning. Its objective is to obtain an income to sustain a target level of consumption. Members of the household do not offer their labour services for the sheer joy of it. Rather, working is seen as an economic necessity for survival. If it did not offer labour services on the

market, the household would have limited opportunities for obtaining an income by any other means.

In labour economics, therefore, households are suppliers of labour. Besides, people are assumed to be rational and seeking to maximize a level of satisfaction called utility. Thus, their utility function is determined by the choice between income and leisure. However, they are constrained by the working hours available to them. To illustrate this concept, we will use shorthand as follows:

Let w denote hourly wage

Let k denote total working hours

Let L denote working hours

Let Π denote other incomes or benefits

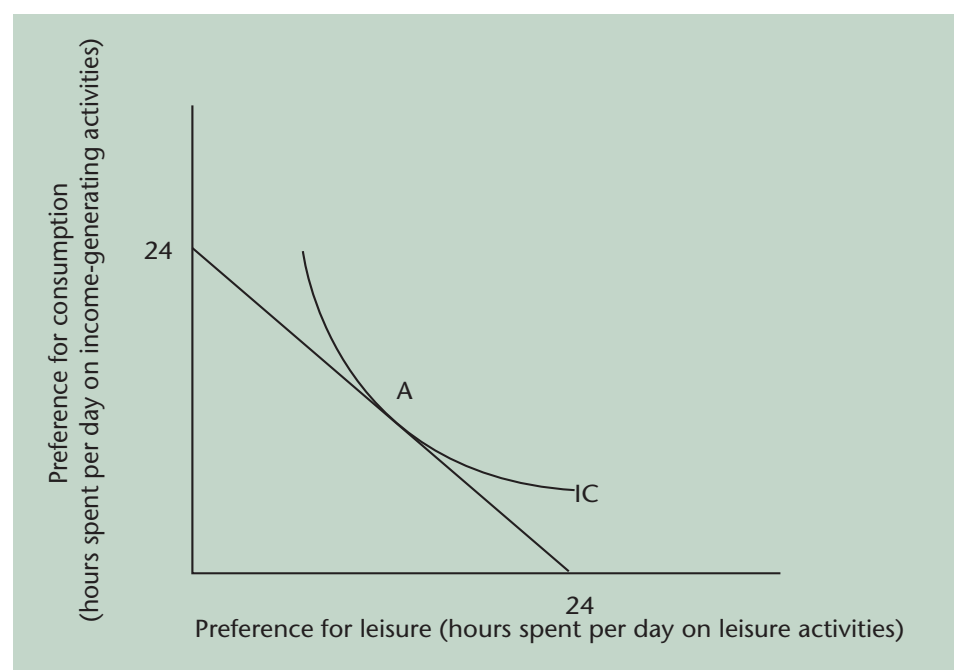
Let A denote leisure hours

The utility function and budget constraint can then be expressed as follows:

Maximize $U(wL + \Pi, A)$ such that $L + A \leq k$.

Figure 4.1 illustrates the trade-off between allocating your time between leisure activities and income generating activities. The linear constraint line indicates that there are only 24 hours in a day, and individuals must choose how much of this time to allocate to leisure activities and how much to working (If the maximum number of hours that could be allocated towards leisure or work are about 16 due to the necessity of sleep). This allocation decision is informed by the indifference curve labelled IC. The curve indicates the combinations of leisure and work that will give the individual a specific level of utility. The point where the highest indifference curve is just tangent to the constraint line (point A) illustrates the short-run equilibrium for this supplier of labour services.

Figure 4.1: Trade-off between leisure and income generating activity



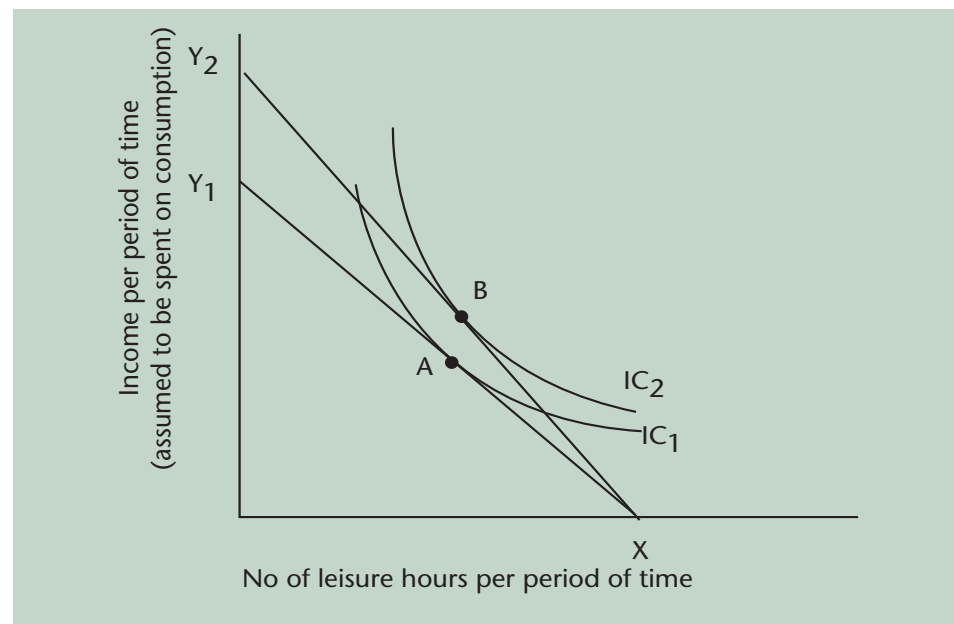
The income-leisure trade-off in the short run

If the preference for consumption is measured by the value of income obtained, rather than work hours, this diagram can be used to show a variety of interesting effects. This is because the slope of the budget constraint becomes the wage rate. The point of optimization (point A) reflects the interaction between the wage rate and the marginal rate of substitution, and leisure for income (the slope of the indifference curve). Because the marginal rate of substitution, leisure for income, is also the ratio of the marginal utility of leisure (MUL) to the marginal utility of income (MUY), one can conclude:

$$MUL/MUY = dY/dL$$

Marginal Rate of Substitution (MRS) refers to the rate at which an individual is willing to trade one good for another while remaining equally well. Mathematically, it is the absolute value of the slope of an indifference curve.

Figure 4.2: Effect of wage increase



Effects of a wage increase

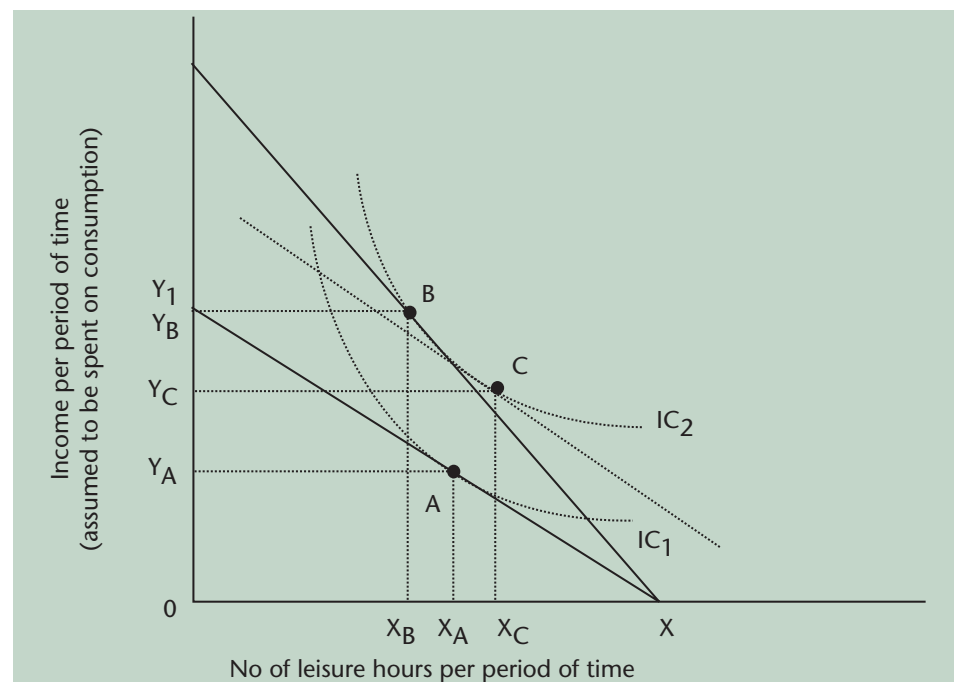
If wages increase, this individual's constraint line pivots up from X, Y_1 to X, Y_2 . He/she can now purchase more goods and services. His/her utility will increase from point A on IC_1 to point B on IC_2 . To understand what effect this might have on the decision of how many hours to work, look at the income and substitution effects.

Income and substitution effects of a change in the wage:

When wage rate increases, a utility maximizing individual may increase or decrease the hours worked. The substitution effect will tend to increase hours worked as the individual substitutes earnings for leisure, which is now relatively more costly. On the other hand, the income effect will tend to reduce hours worked as the individual uses his or her increased purchasing power to buy more leisure hours.

The wage increase shown in the previous diagram can be decomposed into two separate effects. The pure income effect is shown as the movement from point A to point C in the next diagram. Consumption increases from Y_A to Y_C and—assuming leisure is a normal good—leisure time increases from X_A to X_C (employment time decreases by the same amount: X_A to X_C).

Figure 4.3: Income and substitution effects of a wage increase

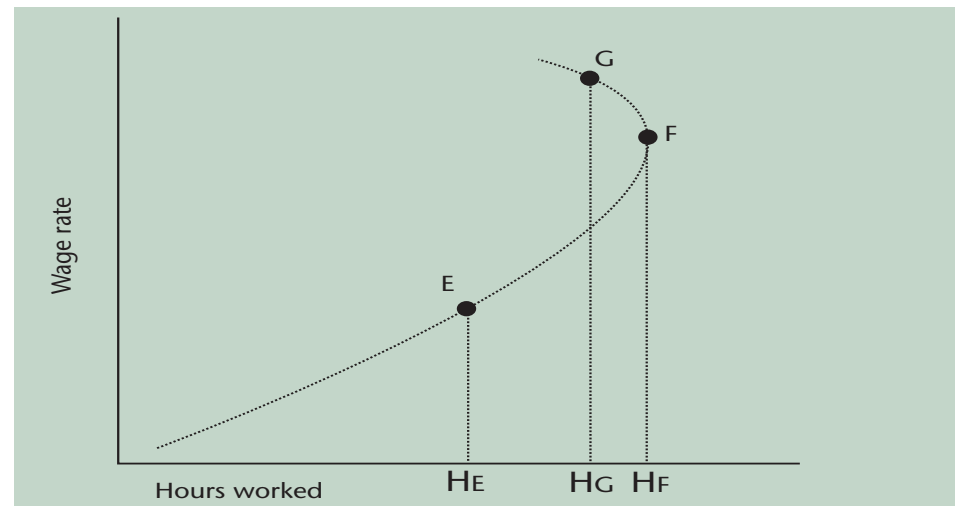


The income and substitution effects of a wage increase in the household's labour supply decision.

As the wage rate rises, the worker will substitute work hours for leisure hours, that is, will work more hours to take advantage of the higher wage rate, or in other words substitute away from leisure because of its higher opportunity cost. This substitution effect is represented by the shift from point C to point B. The net impact of these two effects is shown by the shift from point A to point B. The relative magnitude of the two effects depends on the circumstances. In some cases, the substitution effect is greater than the income effect (in which case more time will be allocated to working), but in other cases the income effect will be greater than

the substitution effect (in which case less time is allocated to working). The intuition behind this latter case is that the worker has reached the point where his marginal utility of leisure outweighs his marginal utility of income. To put it in less formal (but less accurate) terms: there is no point in earning more money if you do not have the time to spend it.

Figure 4.4: Individual labour supply curve



If the substitution effect is greater than the income effect, the labour supply curve (diagram above) will slope upwards to the right, as it does at point E, for example. This individual will continue to increase his supply of labour services as the wage rate increases up to point F where he is working H_F hours (each period of time). Beyond this point, he will start to reduce the amount of labour hours he supplies (for example, at point G he has reduced his work hours to H_G). Where the supply curve is sloping upwards to the right (positive wage elasticity of labour supply), the substitution effect is greater than the income effect. Where it slopes upwards to the left (negative elasticity), the income effect is greater than the substitution effect. The direction of slope may change more than once for some individuals, and the labour supply curve is likely to be different for different individuals.

Other variables that affect this decision include taxation, welfare, and work environment.

Labour demand

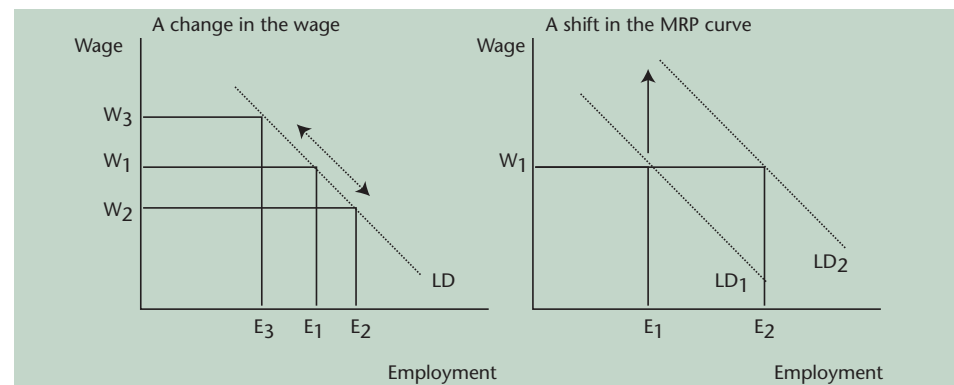
The preceding sections have examined the labour supply curve, which illustrates at every wage rate the maximum quantity of hours a worker will be willing to supply to the economy per period of time. Economists also need to know the maximum quantity of hours an employer will demand at every wage rate. To understand the quantity of hours demanded per period of time it is necessary to look at output production. This is so because workers are only needed for the output they are required to produce. When firms see increasing demand for their products, they will employ extra workers and, thus, the demand for labour increases. For this

reason, economists say that labour as a factor input is a derived demand; it is derived from the output levels in the goods market.

Demand for labour and the market wage rate

There is normally an inverse relationship between the demand for labour and the wage rate that the firm will have to pay for each additional worker. If wages are high, it is more costly to hire extra employees. When wages are lower, labour becomes cheaper than using capital equipment and it becomes more attractive and affordable for the business to take on more employees. Remember that firms are aiming to maximize profits. They will use the factor of production (labour or capital) that does the job as efficiently as possible for the lowest possible cost.

Figure 4.5: Illustrating the labour demand curve



In the left hand diagram, when there is a fall in the wage rate from W_1 to W_2 , the firm will expand employment from E_1 to E_2 . This is because the labour input has become relatively cheaper for a given level of productivity, compared to other inputs. A rise in the wage rate from W_1 to W_3 causes a contraction of labour demand.

Combining labour with capital: Law of diminishing returns

Operating with the most efficient technology available, the firm, in the short run, adds labour (a variable factor of production) to a fixed stock of capital. Adding increasing amounts of labour to a fixed stock of capital yields increased output in a particular way. In most cases, each of the first few units of labour added to a fixed capital stock leads to increasing amounts of output that grow at an increasing rate of change. This is called increasing returns. Adding labour to a fixed stock of capital typically increases output at an increasing rate if capital is under-utilized. Once fixed stock is used more efficiently, however, a stage of decreasing returns begins, in which additional units of labour add to output but at a decreasing rate. As more and more workers are added to the fixed capital, output continues to increase but it increases at a decreasing rate. The additional workers create more output, but no longer grow at an increasing rate. This phase of production is called the stage of decreasing returns, or sometimes the stage of diminishing returns.

The law that governs this phenomenon is called the law of diminishing returns. This is an important principle of production theory. It states that adding a variable factor of production to a fixed factor may yield increasing returns per unit of output initially—when capital is under-utilized—but that diminishing returns set in as more of the variable factor is added to the fixed factor of production. This important law has influence on the demand for labour by the firm.

The reality of the law of diminishing returns

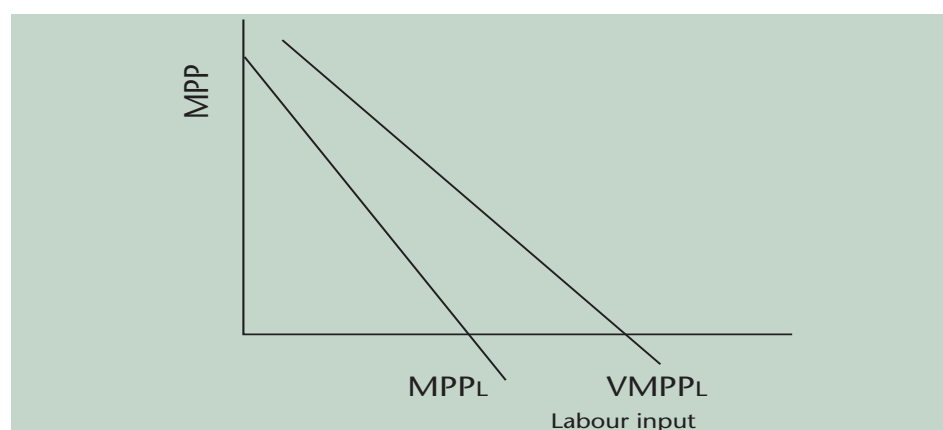
The reasoning behind this law is inherent in the everyday operation of a factory or fast food establishment. Once the optimal number of people is tending the machinery, additional workers tend to cause logjams, overloading the fixed number of machines and buildings with which they have to work. For example, one worker with a sewing machine is probably optimal. Add a second worker and how much more can be produced?

Marginal physical product of labour, marginal revenue product of labour and the value of the marginal product of labour

Now, as firms add labour to the production process, additional output occurs until the point when diminishing returns set in. In this way, a firm is like someone who has gone to a beach for a summer swim and is considering a dip in the ocean, testing the water slowly with one foot to see if he or she wants to go further. The manager of the firm behaves in the same way, testing the waters by adding a little of the factor of production (in this case labour) to see how profits are affected.

Thus, basic to the firm's demand for labour is the additional output that is produced by adding one more unit of labour. Economists call this phenomenon the marginal physical product of labour, which is defined as the additional output (or physical product) that results from an increase of one unit of labour (or from an infinitesimally small increase in labour). In other words, it is the ratio of the change in output to the change in labour input. The additional revenue obtained from the last unit of labour hired is called the Marginal Revenue Product of Labour (MRPL). This is the revenue received from selling the additional output that is produced as a result of hiring an additional unit of labour [If you are not familiar with these concepts, you might want to look at the glossary of terms before continuing with this unit]. The Marginal Revenue Product of Labour is the actual indicator used by the firm in assessing its demand for labour. It is found by multiplying the marginal product of labour by the firm's marginal revenue. Note the difference between this concept and that of the Value of the Marginal Physical Product of Labour (VMPPL). The VMPPL is the product price multiplied by the marginal product of labour, while the MRPL is the marginal revenue multiplied by the marginal product of labour.

Figure 4.6: Marginal physical product and value of the marginal physical product curves



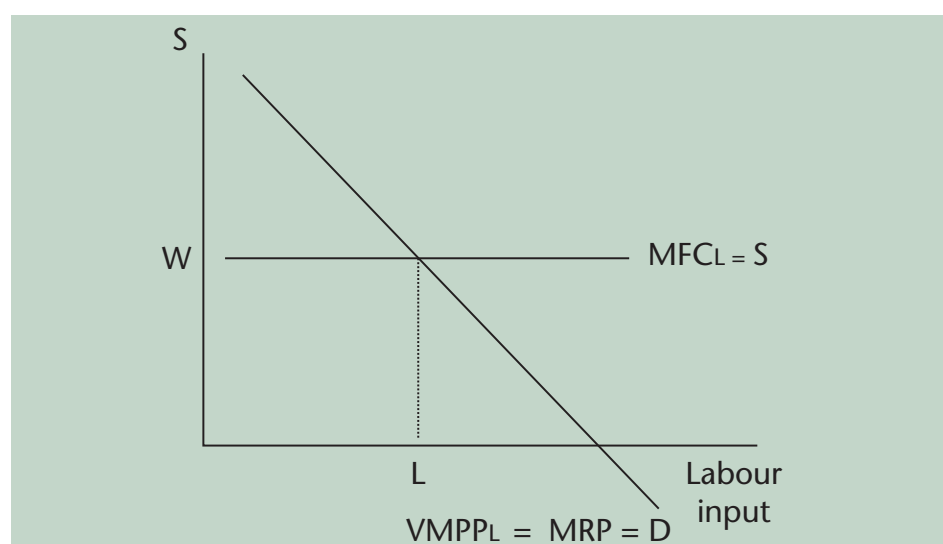
In most industries, and over the relevant range of outputs, the marginal physical product of labour is declining. That is, as more and more units of labour are employed, their additional output begins to decline. This is reflected by the slope of the MPPL curve in the diagram above. If the marginal physical product of labour is multiplied by the value of the output that it produces, we obtain the Value of Marginal Physical Product of labour:

$$\text{MPPL} \times \text{PQ} = \text{VMPPPL}$$

The Value of Marginal Physical Product of labour (VMPPPL) is the value of the additional output produced by an additional unit of labour. This is illustrated in the diagram by the VMPPPL curve that is above the MPPL.

In competitive industries, the VMPPPL is in identity with the Marginal Revenue Product of labour (MRPL). This is because in competitive markets, price is equal to marginal revenue, and marginal revenue product is defined as the marginal physical product times the marginal revenue from the output ($\text{MRP} = \text{MPP} \times \text{MR}$).

Figure 4.7: Labour demand in a competitive industry



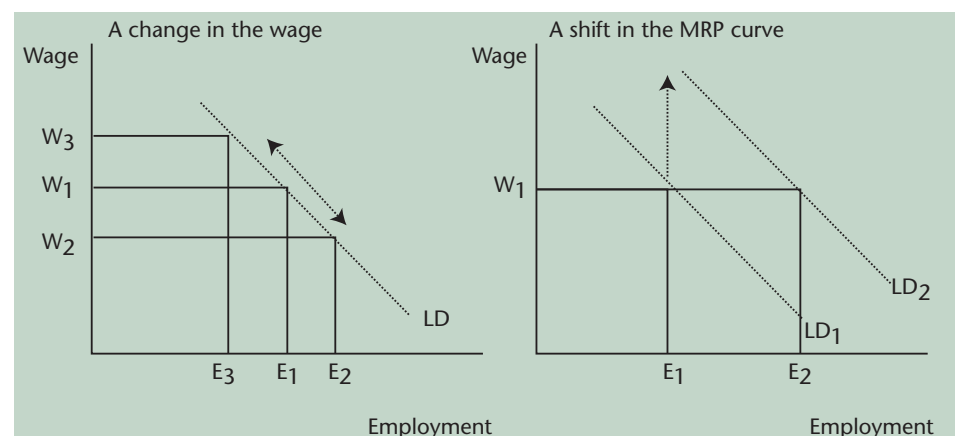
The marginal revenue product of labour can be used as the demand for labour curve for this firm in the short run. In competitive markets, a firm faces a perfectly elastic supply of labour, which corresponds with the wage rate and the marginal resource cost of labour ($W = SL = MFC_L$). In imperfect markets, the diagram would have to be adjusted because MFC_L would then be equal to the wage rate divided by marginal costs. Because optimum resource allocation requires that marginal factor costs equal marginal revenue product, this firm would demand L units of labour as shown in the diagram.

To wrap up the discussion on the demand for labour, it must by now be seen that the firm's demand for labour is described by the schedule of its marginal revenue product of labour. In other words, the labour demand function of a firm is a schedule of its marginal revenue product of labour, which shows the monetary returns for each additional unit of labour employed.

Shifts in the marginal revenue product of labour

Marginal revenue productivity of labour will increase when there is: (a) an increase in labour productivity and/or; (b) an increase in demand for the firm's output, which causes higher prices and raises the value of output produced by the workforce. This will cause an outward shift in the labour demand curve, as shown in the diagram on the right below. For a given wage rate, therefore, a profit maximizing firm will then employ more workers, as denoted by E_2 . Thus, total employment in the market will rise.

Figure 4.8: Illustrating a change in the wage and a shift in the MRP curve



Factors determining shifts in the labour demand curve

- Increase in the number of employers—demand for labour increases, shifting the demand curve to the right
- Increase in the income for employers—employers may demand more labour hence shifting the curve to the right. Alternatively, a government can provide subsidies for employment of labour,

making it relatively cheaper to employ more labour. An example is South Africa's Decentralized Policy

- Technological advancement—increase in the use of technology as a result of heavy capital investments can lead to a decline in labour demand. This shifts the curve to the left
- Increase in the cost of labour—if the general wage level increases, for example the minimum wage, in the longer period, employers may decide on other substitutes for labour, leading to leftward shift in the curve

Problems with marginal revenue productivity theory

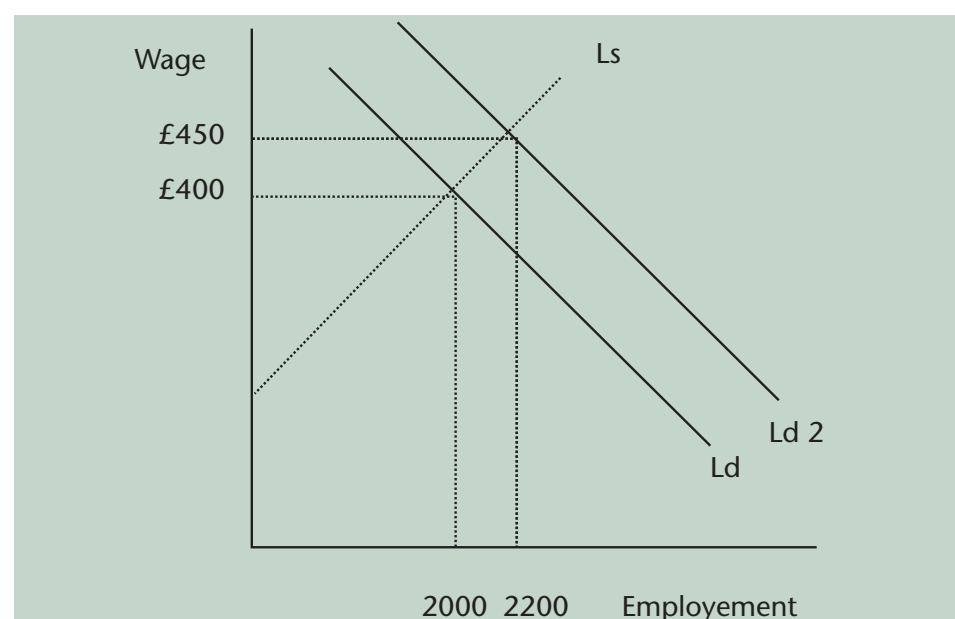
Marginal revenue productivity cannot be used as a valid basis for discussing labour demand for all types of workers. In many cases, it is hard to objectively measure productivity because no physical output is produced by the workforce. Even if productivity can be measured, the output produced may not be sold at a market price. This makes it hard to place an exact valuation on the output of each extra worker.

In other examples, wages may be set independently of the state of labour demand. For instance, public sector workers may have their pay set directly by government. However, marginal revenue product is useful in explaining the demand for labour in many occupations.

Labour market equilibrium

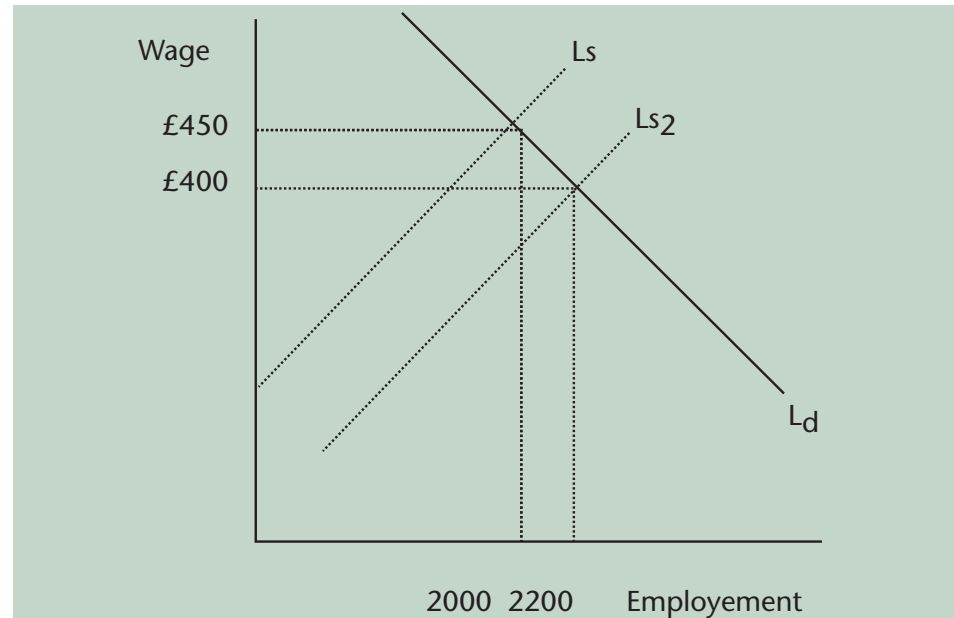
The interaction of labour demand and labour supply determines the market equilibrium wage rate and level of employment. A change in labour demand and/or supply will alter the equilibrium and change wages and employment. When labour demand increases (say, from L_d to L_{d2} as shown in the diagram below) there will be a rise in both wages and employment.

Figure 4.9: Increase in labour demand



On the other hand, a rise in labour supply (see below) causes a downward pressure on wages, although employment increases.

Figure 4.10: Rise in labour supply



When the wage rate is not at the market clearing level, a situation of disequilibrium exists. If wages lie above the equilibrium, there is an excess supply of labour. An excess demand will occur when wages are below the equilibrium. Thus, only at one point, the equilibrium wage rate, will the amount of work that individuals are willing to supply just equal the amount that employers will demand. At any higher wage, the supply of labour will exceed demand and competitive pressures among workers will force the wage down to the equilibrium wage rate. At any lower wage, the labour quantity demanded will exceed the quantity supplied and competition among producers will drive the wage rate up until it reaches its equilibrium level. At the equilibrium wage rate, total employment will be at its equilibrium level. By definition, this will be full employment, i.e. at the equilibrium wage, and only at this wage will all those willing to work be able to obtain jobs.

Do labour markets clear?

So far, the discussion has assumed that wages are flexible and that, therefore, the equilibrium wage equates labour supply and labour demand. However, in reality, it may not be possible to take labour market equilibrium for granted. Minimum wage laws, trade union power, scale economies, insider-outsider distinctions, and efficiency wages are possible explanations for insufficient wage flexibility in the short run to maintain the labour market in continuous equilibrium. Whether the labour market is always in equilibrium, and the length of time for which disequilibrium persists, are questions for which there remains considerable disagreement.

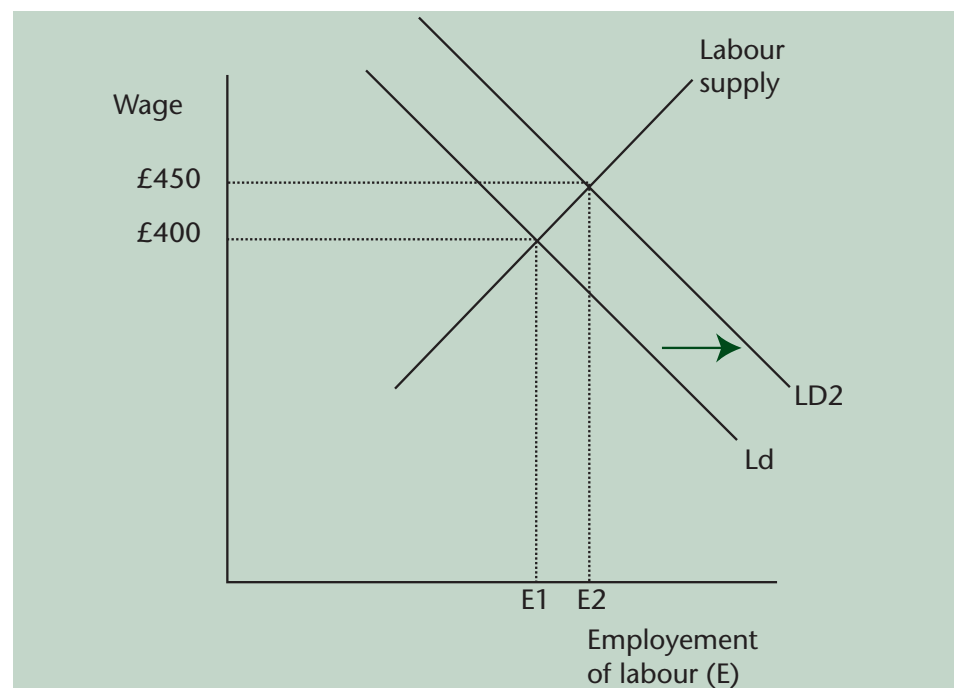
Wage differentials between occupations

No one factor explains the gulf in pay that exists and persists between occupations and within each sector of the economy. Some of the relevant factors are listed below:

- Compensating differentials—higher pay as a reward for risk-taking, working in poor conditions and having to work unsocial hours
- Differences in accumulated human capital—wages and salaries should help to compensate people for making an investment in education. There is an opportunity cost in acquiring qualifications—measured by the current earnings foregone by staying in full or part-time education. The private rate of return on achieving A levels or a university degree should be sufficient to justify the investment made
- Different skill levels—the gap between poorly skilled and highly skilled workers gets wider each year. One reason is that the demand for skilled labour (in both manufacturing and service sectors) grows more quickly than the demand for semi-skilled workers. This pushes up average pay levels. Highly skilled workers are often in inelastic supply and rising demand forces up the “going wage rate” in a particular industry
- Differences in productivity and revenue creation—workers whose efficiency is highest and ability to generate revenue for a firm should be rewarded with higher pay. City economists and analysts are often highly paid not least because they can claim annual bonuses based on performance. Top sports stars can command top wages because of their potential to generate extra revenue from ticket sales and merchandising
- Employer discrimination—a factor that cannot be ignored despite over 20 years of equal pay legislation in place is employer discrimination
- Trade union protection—many workers in low paid jobs do not have trade unions acting on their behalf to protect them from the power of employers

Wages will tend to rise fastest when final demand for the output that workers are producing is rising—i.e. people will enjoy higher pay in industries where output is rising, as revenues and profits are high. The demand for labour shifts to the right and the market equilibrium wage increases. This is shown in the diagram below:

Figure 4.11: Shift in labour demand



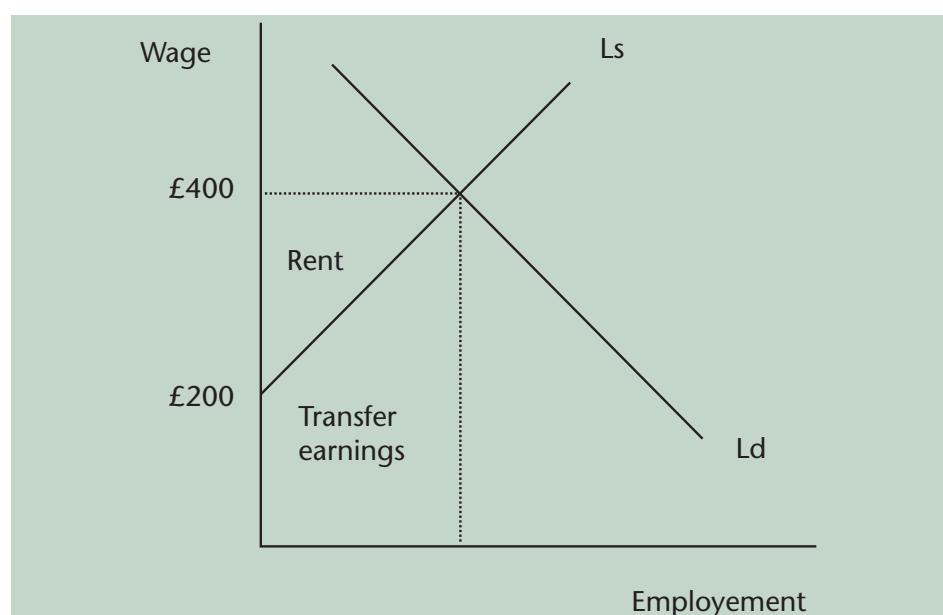
Factors determining shifts in the labour supply curve

- Over-supply of labour—if the labour market is over supplied probably due to migration, the supply curve will shift to the right
- Under-supply of labour—shortage of labour results in a leftward shift in the supply curve
- Attractive occupations—if there are occupations that seem attractive than others, resulting in an influx of employees for that occupation, the supply curve shifts outward to the right
- Discriminatory policies—the more discriminatory a labour market becomes, the less the supply of labour in that market
- Union activities—union activities may limit or increase the supply of labour
- Degree of risk in a particular job—the higher the risk associated with certain occupations, the higher the likelihood of limited labour supply.

Economic rent

Economic rent is defined as the payment to labour in excess of transfer earnings. The area of economic rent is shown by the area above the labour supply curve and below the market wage rate.

Figure 4.12: Economic rent



The breakdown between transfer earnings and rent is determined by the elasticity of supply of labour. In the short run, supply of labour may be inelastic and, therefore, a large proportion of total factor earnings will be economic rent. This is shown in the figure above.

The minimum wage rate that will attract labour into the market is £200. The ruling equilibrium wage is £400, the factor earnings above the labour supply curve and below the market wage shows the economic rent accruing to labour in the market. The remainder of the factor earnings is transfer earnings.

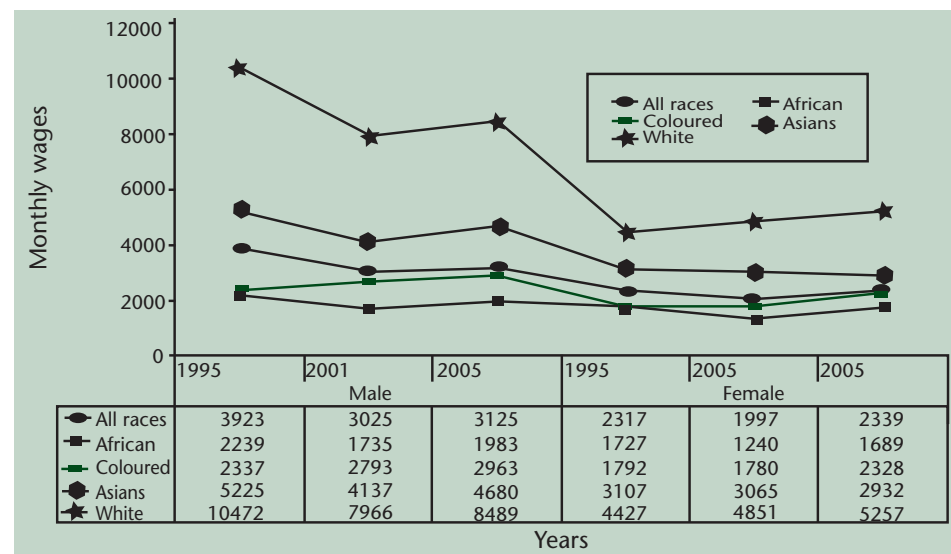
As labour supply becomes more elastic, more of the earnings of labour are transfer earnings.

Illustration of wage differentials: Case of South Africa

Taking an illustrative case of South Africa, it is the case that between 1995 and 2005, real wages remained fairly moderate. Similarly, between 2000 and 2005, average monthly earnings stayed constant at between R2000 and R3000. Figure 4.13 shows that White male workers earn on average the highest wages followed by White female workers. Interestingly, however, the wages of White male workers had the most significant drop of approximately 19 per cent between 1995 and 2005.

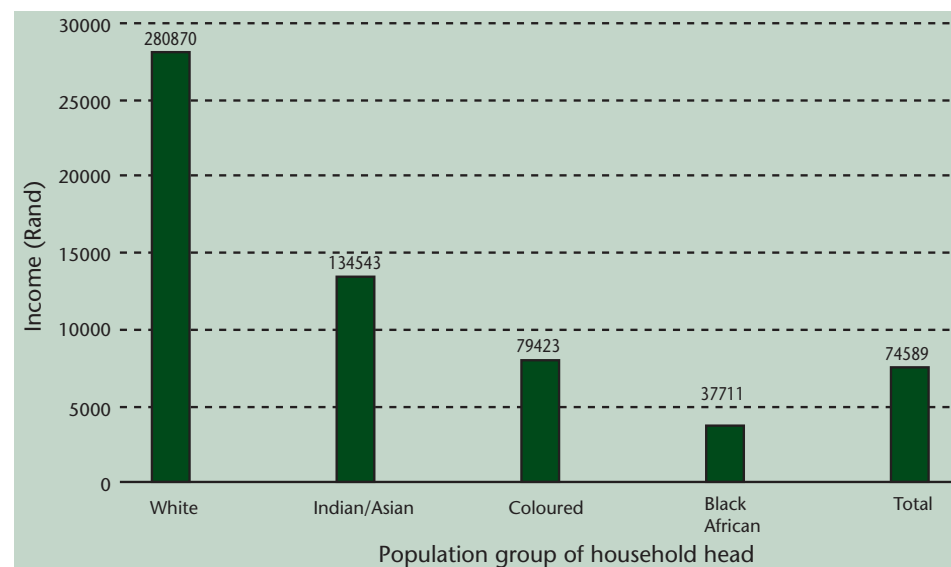
African women earn the lowest wages, which declined slightly between 1995 and 2005. Women experienced a sharper fall in their earnings especially between 1995 and 1998 so that by 2005, their earnings were slightly below the 1995 level. The wages of coloured men increased slightly between 1995 and 2005 while those of coloured women showed the greatest increase of almost 30 per cent. Both Indian men and women recorded declining wages in this period.

Figure 4.13: Real mean earnings for South Africa, 1995-2005



Source: Chart derived from DOL, *Women in SA Labour Market*, 2005: 21 & 23

Figure 4.14: Average annual income of South African households



Source: *Income and expenditure of households*, March 2008;9

The pay of directors in South Africa

The media have made much of the issue of Director's pay in recent years with numerous claims of "fat cat" salaries and generous share-option schemes for the directors of many leading quoted companies.

In South Africa, remuneration for company Chief Executive Officers (CEOs) has been rising considerably in the post-2000 period and studies show that between 2005 and 2006 alone, executive pay rose by as much as 34 per cent. Research conducted by independent analysts, labour research institutions and trade unions indicates that executives in South Africa enjoy a disproportionately high level of earnings in comparison with ordinary workers. In certain cases, executives have been awarded hefty salaries, bonuses and share options at the same time as the performance of their companies has been on a downward trend.

Table 4.1 below presents a comparison of workers' wages with the packages paid to company executives (excluding gains on share options) in four private sectors in 2006. It shows that the lowest gap in remuneration between directors and workers was in the construction sector, where executives were earning at least 186 times more than the average worker. The remuneration gap between CEOs and workers in the retail sector was an exceptional 942 times. Using the comparative figure of R22,000 as the minimum annual wage for workers in the retail sector, it is reported that, in 2005, the overall wage gap between executives and workers was 711 times. Within the retail sector, the gap was 1500 times.¹

Table 4.1: Comparative remuneration for executive officers and workers in the private sector in South Africa (2005)

Sector	Average pay for a Chief Executive Officer (Rand)	Average minimum wage for workers (Rand)	Difference	Average pay for an Executive Director (R)	Average minimum wage for workers (R)	Difference
Construction	3.8 million	15,600	x 224	2.9 million	15,600	x 186
Food and beverage	6.2 million	27,900	x 222	3.9 million	27,900	x 140
Mining	11.6 million	27,600	x 420	7.8 million	27,600	x283
Retail	17.9 million	19,000	x 942	6.9 million	19,000	x 363

Source: Compiled from the LRS: Bargaining Monitor, September 2006: 14-15

¹ Ndung'u 2008

Labour market flexibility

In recent years, much attention has focused on the development of more flexible labour market structures in several leading economies. The United States is often cited as being at the forefront of this process, with the UK economy not far behind. There is an on-going debate about flexibility in the labour market, however. Taking the case of southern Africa, for instance, several firms, particularly in South Africa and Namibia, have argued that government intervention in the labour market creates rigidities, which hinders job creation and economic growth. Some have presented flexibility as the key to greater production output. For the business firms, flexibility is essentially the level of control they have when implementing workplace changes (such as restructuring) speedily and with little costs. In the context of southern Africa, three types of flexibility can be identified, namely:

- Employment flexibility, which refers to the ease with which employers can determine working conditions, hire and fire in line with market demands.
- Wage flexibility, which refers to the firms' ability to set wages unilaterally according to the market forces of demand and supply. This implies that firms may be able to pay different wages for the same level of work.
- Functional flexibility, also called workplace flexibility, which refers to the degree to which the production process can be modified easily and without cost, i.e. the ease with which management can shift workers between tasks. At the core of functional flexibility is multi-skilling through skill development for core workers, along with group work, job rotation, and job enrichment. Jobs are assigned wherever possible to semi-autonomous work groups, which are free to rotate them among their members. The objective of seeking functional flexibility is undoubtedly the full utilization of labour. Looked at from another perspective, therefore, this might only be a euphemism for work intensification.

Demands for a more flexible labour market

The need for greater flexibility in the labour market has come from several sources. Indeed, in many cases, it is the demands of the workforce that have promoted temporal flexibility in many occupations. In the southern Africa labour market, for instance, high levels of flexibility are due to large numbers of unemployed workers who are desperate to accept any job at almost any condition, and also due to the huge economic power imbalances between the owners of business firms and households supplying labour services. However, the changing business environment and the need for maintaining global competitiveness, technological advances, and new human resource management practices have equally acted, leading to increasing demand for labour market flexibility. Other factors leading to more flexible labour market include the changing social

environment (e.g. increasing female participation ratios, early retirement and rising divorce rates). Government policy has also in some cases encouraged labour market flexibility.

Costs and benefits of a flexible labour market model

Benefits

- Improved inflation-unemployment trade-off
- Reduced lag between output and employment
- Potential for increased efficiency at a micro level
- Flexible employment, which suits more flexible lifestyles

Costs

- Training deficit for part-time staff. Are firms devoting sufficient investment to improving the human capital of their workforce?
- Greater job insecurity and workplace stress
- Rising inequalities
- Income uncertainties—as the balance of risk in the workplace shifts from the employer to the employee

4.3 Labour unions and wage determination

Trade unions as economic institutions

“The happiness of men consists in life. And life is in labour.”

Leo Nikolaevich Tolstoy, Russian moral thinker, novelist and philosopher, notable for his influence on Russian literature and politics (1828-1910)

A trade union is a workers’ organization, which is controlled by its members, run by or on behalf of its members, and paid for by its members. In joining a trade union, workers hope it will help them to secure better pay, receive protection from unfair treatment, achieve better working conditions and have security of employment, among many other benefits. From an economic perspective, however, a trade union can be conceived of as an institution that receives inputs from a variety of external sources, then filters those inputs through its own unique organizational internal structures and finally produces certain outcomes. When modelled this way, the inputs received by the trade union are:

- The unemployment rate, which is an indicator of general conditions of demand and supply in the labour market;
- The structure of the industry in which the union operates, including the degree of competition in the product market;
- The orbits of coercive comparison—that is, the other unions operating in similar industries to which the union in question has historically been compared;

- The state of public opinion about unions (is the public, in general, favourably or unfavourably disposed toward unions?); and
- The legislative, executive, and judicial environments in which the unions have to operate (at different times, unions receive a more or less favourable hearing in the courts, the executive offices, and the legislature in the nation).

These elements of the union's environment exist external to its own decision-making apparatus, yet they heavily influence the decisions a union makes. Unions attempt to influence these external forces and make them as favourable as possible to their own case.

Facing these same external factors, different unions will reach different decisions about collective bargaining objectives depending on the internal structures of the union. This often neglected aspect of union behaviour is critical in understanding how a union sets priorities when it faces trade-offs between two equally desirable objectives. There are a number of aspects of the internal union structure that influences the character of the union's objectives. These include:

- Age structure of union members
- Skill and occupational composition of the membership
- The existence and or size of the strike fund
- Degree of internal union democracy
- Union history, tradition and leadership

These are the more important internal structures of the union, which filter or mediate the inputs from the external environment in which the union operates. What results is a series of outcomes; the decision the union makes when it is engaged in collective bargaining and when it proceeds with its normal day-to-day operations. These outcomes take the form of:

- The wage policy of the union, including issues of wage structure among skill and occupation groups, the trade-offs between wage increases and fringe benefits, and the general level of wage increase the union will attempt to achieve during collective bargaining process;
- The form of work rules the union will press for, including seniority rules, vacation times, and health and safety issues on the job; and
- The allocation of the union's own resources, for example, the internal budgetary allocations within a union—the amount of resources set aside for new organizational campaigns, for education of the union members, for the strike fund, and so forth.

The trade union, viewed in this fashion, becomes a complex, large, modern institution that has to reach decisions based on a set of external

and internal factors. Above all, it is an institution that has grown and asserted itself with a natural presence in any modern workplace and, thus, a major player in wage determination.

Trade unions and wage determination

Discussion of wage determination cannot be complete without examining how unions influence this process. The “pure theory” of wage determination based only on the interaction of market forces of labour supply and demand ignores the institution of trade unions and its role in the process of wage formation. For instance, in the marginal productivity model discussed earlier, the household is at the centre of labour supply decisions. Its decisions cannot influence the wage rate. Instead, the individual supplier of labour is represented as a passive responder to wage information received from the labour market.

However, the institutional reality of a living economy is obviously quite different. In many sectors of the economy, large and powerful labour unions bargain over wages and other matters directly. In those sectors that are not unionized, the wage is influenced by agreements arrived at in the unionized sectors of the economy. Where a trade union exists, wages are determined through a process of collective bargaining. Although it is not possible to say definitely what the wage outcome will be of a collective bargaining situation, it is feasible to identify the economic conditions that will place either labour or management in a more strategic and powerful bargaining position. So long as the cost to one side of agreeing to the other’s terms is greater than the costs associated with holding out for better terms, an industrial dispute in the form of a strike is likely to occur. Each side then tries to influence its economic environment so that it lowers the costs of disagreeing for itself while increasing the costs of recalcitrance for the other side.

A union will be in a stronger position if it has a large strike fund, for example, because the costs of holding out are reduced. It is also in a stronger bargaining position if the unemployment rate in the economy is low, since its members will not be threatened with dismissals if they opt to go on strike, thereby lowering its cost of disagreement. Equally, the degree of unity and solidarity among the membership will enhance the bargaining position of labour.

On the other side of the bargaining table, an employer will be in a stronger position if it has been able to stockpile inventories, which it can then sell off during a strike, thus lessening the costs of the strike itself.

Time is the most important factor in settling an industrial dispute. A mediator can influence the costs on both sides of agreement and disagreement through adroit handling of the negotiation process. Eventually, all strikes are settled because of the factor of time. As the industrial dispute drags on, both sides start to experience heavier cost for holding out. The union and its members face drain on financial resources, and the firm’s inventories start getting exhausted. At this point, settlement is imminent, although in the timing of a settlement and in its final terms, the art of the negotiator comes into play.

Aside from its role as a bargaining agent for improved wages and other conditions of work for its members, there are other theories of the union that see it as a maximizer of revenues. The union seeks to maximize its revenues through the optimal combination of wages, which influence its level of dues, and membership, which is affected by the level of employment. A number of external forces, however, may also influence the menu of union proposals: for instance, the age and skill composition of the union membership, the emergency of rival unions within the industry, among others. Trade unions, therefore, use several strategies to increase the wages of their members: increase the demand for labour; restrict the supply of labour; or impose an above equilibrium wage floor on the market. Thus, a strong trade union may act in a similar way as does a minimum wage law, implying that if unions in an industry force firms to pay a wage above the equilibrium wage, the result is fewer jobs in the industry. By raising the wage above the market equilibrium, the union acts in a way that reduces employment. The resulting unemployment is collectively voluntary—members of the union chose this action—but may be involuntary for the unlucky union members who lose their jobs.

4.4 Labour and the macro economy

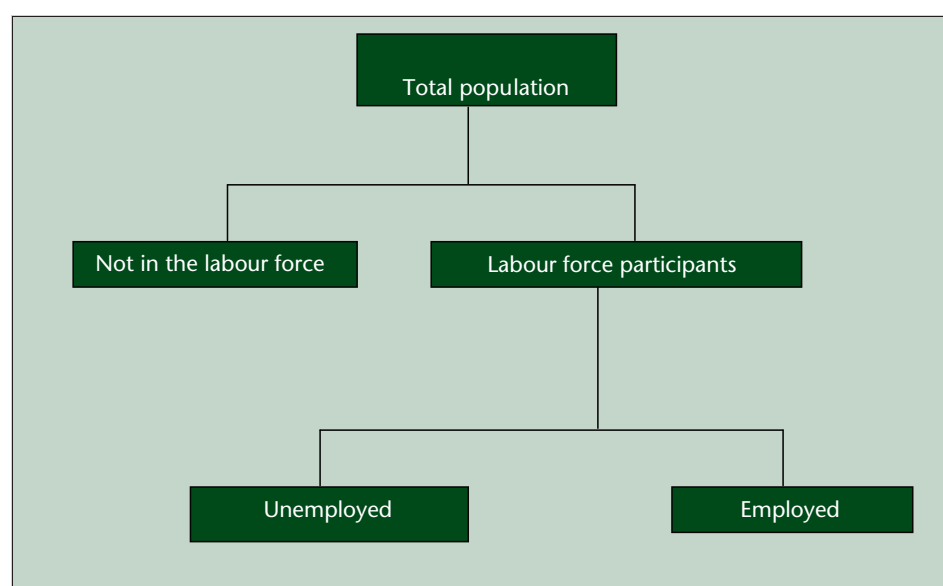
Unemployment: Meaning and measurement

Often times, the press report statistics on the unemployment rate. It has gone up or down by a fraction of a per cent point; the unemployment rate for youths is at a certain level; the rate for women is at a different level, and so on. We take for granted that these announcements about the unemployment rate have some meaning in terms of the way the economy is functioning, the strength or weakness of the economy, and the stage of the business cycle (whether the economy is entering a recession or recovering from one). Unemployment rate also connotes some sense of individual welfare in addition to its implications about the economy. Economic distress is associated with a high level of unemployment.

What does the unemployment rate measure and what does it mean?

The labour force in an economy provides the launching point for a discussion of unemployment—its meaning and measurement. The labour force is the most inclusive statistic on wage and salary earners in the economy. It includes those people working as well as those unemployed. Individuals of working age (usually 15 to 65 years old), not presently housed in an institution (such as a prison or mental institution), are considered in the labour force if they are either employed or unemployed. Being employed or unemployed constitutes participation in the labour force and individuals in either of those two categories are called labour force participants. An individual who is neither employed nor unemployed yet is at least 15 years old and not housed in an institution, is called a non-participant in the labour force. The labour force categories are shown schematically in the figure below.

Figure 4.15: Labour force categories



The relationship between those in the labour force and the total eligible population is called a labour force participation rate. The table below shows labour force participation rates for Zambia as captured in the Labour Force Survey 2005. The labour force participation rate in Zambia is rather on the high side, largely because of the expanding informal sector employment. According to the Labour force Survey (2005), out of 6.2 million persons aged 15 years and above, 80 per cent were in the labour force, leaving only 20 per cent out of the labour force, as shown in the table.

Table 4.2: Labour force participation rates (%) in Zambia in 2005

	Labour force participants			Not in labour force		
	Both sexes	Male	Female	Both sexes	Male	Female
Residence	80	86	74	20	14	26
All Zambia						
Rural	87	90	85	13	10	15
Urban	67	79	55	33	21	45
Province						
Central	77	85	70	23	15	30
Copper belt	64	74	54	36	26	46
Eastern	90	93	88	10	7	12
Luapula	91	95	87	9	5	13
Lusaka	66	79	54	34	21	46
Northern	90	93	86	10	7	14
North-Western	88	89	87	12	11	13
Southern	82	89	76	18	11	24
Western	87	88	87	13	12	13

Source: Labour Force Survey (2007:19)

What distinguishes between being counted as unemployed from being considered not in the labour force?

There are thin lines in the official government statistics between the classifications of being employed, being unemployed, and not being in the labour force. Many times, the division among these three categories is ambiguous. The most widely held belief is that the official definition of unemployment—that statistic we often hear about—includes all individuals who are not presently employed but would like to work. This is not the case. Not only must an individual be unemployed and desiring work, he or she must also be actively looking for work. The central statistical offices, which collect and publish unemployment statistics in most economies, define unemployment as including “those who did not work at all during the survey week, were looking for work, and were available for work”. Most central statistics offices go on to specify what constitutes looking for work: registering at a public or private employment agency, applying for work directly, answering newspaper adverts, and so forth. Within the same context, the ‘employed’ normally comprise all persons between the ages of 15 and 65 who during a specified period performed some work for a wage or salary or had a formal attachment to their job or were in self employment.

In short, in order for a person to be officially counted as unemployed, he or she not only must be out of work but must be actively seeking a job, as evidenced by actions during the particular period of time for which the survey is taken.

If you are unemployed but have not evidenced active job-seeking behaviour in a specified reference period, you are counted as neither employed nor unemployed but considered to be not in the labour force. This ambiguity is what has occasioned some controversy surrounding the measured unemployment rate. Some critics argue that unemployment rate understates the phenomenon it seeks to measure because many able-bodied and willing workers do not get counted as unemployed if they have not met the central statistical office’s set criteria for active job-seeking. Others contend that the unemployment rate overstates the problem because it is not sensitive to the intensity of interest in finding work. More critical perhaps is that the labour force is constantly changing, while the measured unemployment rate is a static snap shot.

The unemployment rate is the number of people unemployed divided by the labour force – the number of people holding or seeking jobs.

Unemployment rate = No. of persons unemployed/No. of persons in labour force

Kinds of unemployment

Not everyone who is unemployed is unemployed for the same reason. Unemployment is classified into three main types based on its causes.

Some people are unemployed because they cannot currently find work that matches their qualifications. For example, think of college students majoring in accounting or computer sciences. When they finish school, they will look for jobs that match their skills, but finding such jobs may take time. Yet, students will likely find jobs soon because their skills are marketable. This unemployment is temporary. Economists refer to this type of unemployment as frictional unemployment. Frictional unemployment is the unemployment that arises from normal labour turn-over—that is, from people being “between jobs.” Frictional unemployment is not of much concern when dealing with the national unemployment problem. However, not all unemployment is short-lived. Structural unemployment is unemployment caused by skills that do not match what employers require, or from being geographically separated from job opportunities. Substantial structural unemployment is found quite often side by side with job vacancies, because the unemployed lack the skills required for newly created jobs. For example, there may be vacancies for electrical engineers while truck drivers are unemployed. Moreover, there may be worker shortages in regions within an economy that are experiencing growth and unemployment in provinces or regions that are suffering contraction. Because both skill and location problems are usually long duration, structural unemployment is perhaps the most serious type of unemployment.

Cyclical unemployment is the fluctuating unemployment that coincides with the business cycle. Cyclical unemployment is a repeating short-turn problem. The amount of cyclical unemployment increases when the economy goes into a slump and decreases when the economy goes into expansion. A construction worker who is laid off because the economy enters a recession and gets rehired several months later when the upswing occurs has experienced cyclical unemployment. Government policy makers are especially interested in decreasing both frequency and extent of this type of unemployment by reducing the frequency and extent of the recession that account for it. Governments in wealthy economies also attempt to lessen the impact of recession by providing unemployment compensation for those temporality laid off.

Tackling unemployment

Government has many policies and programmes at its disposal to reduce unemployment. Depending on the unemployment causes, a number of policy prescriptions can be used. The table below summarizes four major policy prescriptions that are normally used.

Table 4.3: Unemployment causes and policy responses

Cause of unemployment	Policy response
Wage in excess of market-clearing level	Elimination of barriers to market adjustment
Insufficient aggregate demand for labour	Fiscal and monetary policies to stimulate aggregate demand
Imbalances in economy, caused by dynamics of economic change	Re-orienting education and training doctrine, job information, and re-location policies
Character of jobs in the secondary sector	Training policies and economic restructuring to change jobs in the secondary sector

Full employment

What do economists mean by full employment? Does full employment mean zero unemployment? Recall that total unemployment in an economy consists of frictional, structural and cyclical unemployment. We call the level of unemployment at which there is no cyclical unemployment the natural rate of unemployment. In other words, the natural rate of unemployment is the sum of frictional and structural unemployment, which economists consider as essentially unavoidable. The natural rate of unemployment is the economist's notion of full employment. Therefore, we define full employment as something less than 100 per cent employment of the labour force.

Informal and gender dimensions of employment

On the African continent, waves of economic adjustment programmes have slashed formal sector employment, leaving the informal economy as the only refuge for retrenched workers. The result of combined processes of economic adjustment has been that formal employment in the primary labour market has lost its importance. In Zambia, for example, as the formal sector contracted and was unable (or unwilling) to create new jobs, the informal economy grew in size.² Given the contraction of the formal sector, many retrenched workers sought refuge in the informal economy. In addition, many workers have had to supplement diminishing income from wage employment in the formal sector with earnings from activities in the informal economy, often doubling or tripling the number of jobs one person holds. At the same time, there has also been observed the 'informalization' of the workforce in a number of industries that are taking advantage of the deregulated labour market to exploit unlimited supplies of domestic labour.

Declining formal sector employment in many parts of Africa has been associated with an expansion in informal employment. In other words, informal employment has responded, desired or otherwise, to the effects of economic adjustment. Overall, then, with the contraction of the formal

² While the phenomenon of the informal economy is not new in Zambia, evidence suggests that the informal economy rapidly expanded during the structural adjustment episodes of the 1990s. See for instance Muneke 2001.

sector, there has been a noticeable rise in informal jobs, a growth in a wide range of informal economic enterprises, and the 'informalization' of the workforce in many industries.



<http://www.gadonet.com>

A Central Statistics Office (CSO) survey on living conditions in Zambia that was carried out in 2004 found that 81 per cent of all employed persons in Zambia were engaged in the informal economy (see table below). The survey defined informal employment as "employment where the employed persons were not entitled to paid leave, pensions, gratuity and social security and worked in an establishment employing five (5) persons or less". The table also shows that informal economy employment was more common among females (89%) than males (74%). Table 4.4 further demonstrates that only 11 per cent of women in Zambia have jobs in the formal sector.³

Table 4.4: Proportion of labour force in Zambia aged 12 years and above employed in the informal economy and formal economy, by sex and location, 2004

Sex/ Residence	No. of people employed in formal sector	% share of formal sector	No. of people employed in informal economy	% share of informal economy	Total No. of employed
All Zambia	751,376	19	3,203,236	81	3,954,612
Males	543,509	26	1,546,910	74	2,090,419
Females	205,061	11	1,659,132	89	1,864,193
Rural	221,238	8	2,516,584	91	2,765,477
Urban	511,328	43	677,807	57	1,189,136

Source: Government of the Republic of Zambia (2005:65); Living Conditions Monitoring Survey 2004; CSO: Lusaka

In Africa, therefore, employment is increasingly taking on informal dimensions and the frontline victims seems to be women, whose per cent share of informal employment is quite huge—as shown by the case of Zambia.

³ An earlier survey (LCMS 2003) had further reported that almost 54 per cent of these households that reported to operate non-farm enterprises were involved in trading (see also a report by War on Want entitled "informal economy organizations in Africa 2006:25).

Inflation: Meaning, measurement and causes

When used in an economic sense, the term inflation refers to the increase in the general level of prices of goods and services in an economy. Inflation is measured by the Consumer Price Index (CPI), which tracks changes in the prices consumers pay for a fixed basket of goods and services. The CPI is calculated by the central statistics office through its sampling of a number of households and businesses. When the news report says that the “cost of living” rose by say 3 per cent, it usually refers to the CPI.

In constructing the CPI, the central statistics office selects a “market basket” of a given number of goods and services that are assumed to be the most crucial to the spending of the typical consumer in a given country. It then assigns weightings to these goods and services according to past patterns of consumer expenditures. Every month, price surveys are conducted to collect prices of goods and services to compute the current cost of the market basket.

The central statistics office arbitrarily sets the average value of the goods and services in the market basket for some base period, say 1982–1984 = 100. Referring to the table below, we see that the CPI for this country was 172.0 in 2000. This means that prices in 2000 were 72 per cent higher than the prices in the base period. A typical bundle of goods and services that was worth R1,000 in the base period would have cost about R1,720 in 2000 ($R1,000 \times 1.72 = R1,720$).

Once we have the CPI for selected years, we can now calculate the rate of inflation between the years. We use the following formula:

$$\text{Rate of Inflation} = \frac{(\text{CPI}_{\text{given year}} - \text{CPI}_{\text{previous year}})}{\text{CPI}_{\text{previous year}}} \times 100$$

For example, suppose we wanted to compute the rate of inflation between 1999 and 2000. Referring to table 4.5 below, we see that in 1999 the CPI equalled 166.6 and in 2000 it equalled 172.0. The rate of inflation between the two years thus equals 3.2 per cent.

$$\text{Rate of inflation} = \frac{(172.0 - 166.6)}{166.6} \times 1000 = 3.2 \text{ per cent}$$

Table 4.5: Consumer price index for selected years for country Z (1982-1984 =100)

Year	CPI
1991	136.2
1992	140.3
1993	144.5
1994	148.2
1995	152.4
1996	156.9
1997	160.5
1998	163.0
1999	166.6
2000	172.0

But why are economists concerned about inflation? First, because inflation can greatly affect the national standard of living and, second, it can also affect economic behaviour that can have significant impacts on the operation of the economy. Taking the case of a worker represented by a trade union at the bargaining table, it is interesting to know whether the wage increase being demanded will beat inflation or whether inflation will beat you. In other words, will your nominal income be increased by a smaller per cent, the same per cent, or a greater per cent than the inflation rate?

To answer this question, we must adjust the nominal income for changes in the price level. Nominal income is the actual income received. Real income is the actual income received adjusted for any changes in inflation. Real income, therefore, measures your real purchasing power, the amount of goods and services that can be purchased with your nominal income. Real income is computed as follows:

$$\text{Real Income} = [(\text{nominal income}/\text{CPI})] \times 100$$

This formula can help us determine whether we beat inflation. For example, assume that Naomi's nominal income rises from R50,000 in 1999 to R56,000 in 2000, an increase of 12 per cent. Also suppose the CPI rises from 150 in 1999 to 165 in 2000, an increase of 10 per cent. Because Naomi's income has risen by a greater per cent than the inflation rate, she has more than kept up with inflation. In other words, her real income has risen from 1999 to 2000. Using the preceding formula, we can calculate her real income, stated in terms of the base year, for the two years:

$$\begin{aligned}\text{Real income}_{1999} &= (50,000/150) \times 100 = \text{R}33,333 \\ \text{Real Income}_{2000} &= (56,000/165) \times 100 = \text{R}33,939\end{aligned}$$

Naomi's income has risen from R33,333 in 1999 to R33,939 in 2000

The preceding example helps us see how inflation affects real purchasing power. If your nominal income increases by a greater per cent than the inflation rate, your purchasing power rises. But if the inflation rises faster than your nominal income, your purchasing power falls.

But what causes inflation? Recall that inflation is an increase in the general price level of prices and that prices are the result of the interaction of buyers' demand and sellers' supply decisions. Therefore, inflation may be caused by forces taking place on the buyer's side of the market or the seller's side of the market. Inflation originating from upward pressure on the buyers' side of the market is called demand-pull inflation. Inflation caused by upward pressure on the seller's side of the market is termed cost-push inflation. Demand-pull inflation occurs when buyers' demands to purchase goods and services outrun sellers' capacities to supply them, thus forcing up prices on what is available. Business cannot respond to this excess demand because all available resources are fully employed. Demand-pull inflation is often described as a situation in which "too much money is chasing too few goods"

However, some economists argue that inflation is caused on the sellers' side of the market. When business raises prices in response to cost increases, the result is cost-push inflation. Workers then may demand higher wages to keep up with rising prices, and a wage-price spiral occurs. If wages and prices rise but production does not, the supply of goods and services cannot meet the demand for those items. Cost-push inflation also occurs if a limited number of businesses control the supply of certain products. The increase of oil prices during the 1970s provides a good example. During this period, the Organization of Petroleum Exporting Countries (OPEC) limited supply of oil to drive up prices and thus earn higher profits. Because oil is a resource used to make other goods, the cost of those items also rose, resulting in cost-push inflation.

4.5 Labour and public policy

Minimum wages legislation

A minimum wage is the smallest amount of money per hour or per month that an employer can legally pay a worker. In most African states, this minimum wage is supported by the enactment of a Minimum Wages Act, which provides a standard for the barest minimum that can be paid to workers either at the national level or in a specific sector. The minimum wage legislation, therefore, provides a wage floor that all employers are obliged to observe. In a developing country context, such as Africa in where levels of unemployment are rather on the high side, there has been a tendency by firms to seek to exploit this excess labour supply by paying wages that do not reflect the true contribution of labour to output or company profits. Minimum wage legislation, therefore, becomes a necessary means of protecting vulnerable sections of the workforce.

In Zambia, for instance, the Minimum Wages Act was revised in 2006 to provide for a national minimum wage of K268,000 per month. It is to be revised periodically with appropriate involvement of all stakeholders. This legislation is primarily meant to protect workers that have no benefit of collective bargaining or union representation in the determination of their wages and conditions of service. In a country where about 88 per cent of employment is in the informal economy, where union presence is virtually non-existent, it becomes necessary that such a law must be established and implemented in order to safeguard the individual and collective interests of unprotected workers. As such, minimum wage has had its greatest impact on the market for informally employed workers, the majority of whom are employed on casual basis and short-term contracts. Because casual workers (mainly youths) are often the least experienced members of the labour force in Zambia, the market equilibrium wage rate tends to be lower than what would be socially acceptable, hence the importance of a minimum wages law. Moreover, these categories of the labour force are often willing to accept low wages because of their desperate situation of poverty. A minimum wage has, therefore, guaranteed their protection from exploitative employers.

The growing phenomenon of the informal economy in most parts of Africa attests to the relevance of enacting a minimum wages law to safeguard

informal and other unprotected workers and, thus, ensure observance of acceptable labour standards. To this effect, trade unions must assert themselves in processes that establish minimum wage law. The Zambian case, in which trade unions were involved in the revision of the Minimum Wages Act, provides a precedent that can be emulated elsewhere. The traditional argument that minimum wage raises the wage rate above the equilibrium wage and, thus, decreases the quantity of labour demanded (leading to job losses) may not be a sufficient basis not to support minimum wage legislation. If a wage hike causes the marginal productivity of labour to increase, it is the case that the demand for labour would increase and unemployment would decline.

Overall, the main objective to be considered while fixing or revising the minimum wage rate should be twofold: (i) Social objective: that is, by providing sufficient purchasing power to the worker, enable him/her to have a basic standard of living. In the long run, such a step would help in abolishing labour exploitation and poverty; (ii) Economic objective: The rate of minimum wage should be fixed at such a level that would motivate workers and enable them to enjoy the benefits of economic growth, and thereby contribute to the economy.

Social security, health and safety

Social security policies deal with instances in which the earning capacity of the individual or family is ended or interrupted. For example, when loss of employment causes interruption in income received by a family, severance payment or other forms of unemployment compensation are the public policy response to this unforeseen event. Or suppose a worker receives a temporary or permanent injury on the job. Income is interrupted in the case of a temporary injury and permanently ended in the case of a more serious injury. Workers' compensation schemes provide income to families and individuals when such injuries occur.

The largest and most comprehensive of all income security schemes is the social security system. In most African countries, the social security system has become the centrepiece of income security policy. The best known of all the aspects of this system is income for retirees. For instance, in Zambia, like in many other African countries, social security is mandatory and mainly provides pensions and short-term cash benefits to the formal sector workers. Estimates show that more than 90 per cent of the formal sector workforce is covered by pension schemes. However, this is only about 13 per cent of the labour force. The bulk of the workers in the informal economy are currently not covered even though policy processes are underway to find the best way of extending coverage. The schemes typically provide protection against loss of income due to, for example, retirement and invalidity.

Statutory pension schemes in Zambia

There are three statutory pension schemes that provide income replacement upon retirement, disability and survivorship: National Pension Scheme Authority (NAPSA), Public Service Pensions Fund (PSPF) and Local Authorities Superannuation Fund (LASF). There is also one work injury scheme providing employment injury protection: Workers Compensation Fund.

The largest statutory pension scheme is NAPSA with about 360,000 members. NAPSA is a compulsory defined benefit scheme that covers “regularly employed persons in the private, parastatal sectors and all civil servants employed after 1st March 1997”. Employers and workers share contributions to the schemes equally: 5 per cent each of the employee’s monthly earnings. Only those whose incomes fall below K15,000 and armed forces personnel are exempted. Though the policy framework provides for workers in the informal economy to register voluntarily for membership with the scheme, there is no information of how many members are from the informal sector.

Civil servants, including teachers and Defense Forces, are covered by the Public Service Pensions Fund (PSPF), which has a total membership of 157,066. On the other hand, local government employees, National Housing Authority and Zambia Electricity and Supply Corporation (ZESCO), are covered by the Local Authorities Superannuation Fund (LASF), which has an estimated total membership of 20,335.

Taken together, social security constitutes a key pillar of public policy in areas of income security, health and safety. The current challenge for social security in Africa, however, is how to extend coverage to workers in informal employment.

Labour migration

Labour migration is a significant feature of the international labour market. In the southern African sub-region, for instance, it developed throughout the last century, initially as a response to the labour needs of mining operations in South Africa. The migrant labour system was later expanded to the agricultural and manufacturing sectors and had a strong influence on the structure of labour markets in southern Africa. The common migration flows in Africa today can be identified as:

- Rural-urban migration in search of work and livelihoods;
- Short-term trade migration related to informal activities, e.g. cross-border trading;
- Migration of low-skilled workers to jobs in the mining and agricultural sectors of neighbouring countries;

- Migration of highly skilled workers to countries with higher levels of income. In the southern African sub-region, for instance, there has been observed migration of health workers and teachers from such countries as Zambia and Zimbabwe to Namibia, Botswana and South Africa; and
- Migration of politically motivated refugees, for instance, those running away from political turmoil in their own countries.

The distinction between political and economic refugees is often arbitrary, as some migrants initially leave for political reasons and later on do not return home for economic reasons. Labour migration is a common feature in southern Africa and poses challenges for the countries and communities receiving and losing the migrants. In some cases, migrants may add to the already high number of unemployed workers in a particular country and, thus, may face an antagonistic response from their hosts. In other cases, migrant workers may constitute a “brain drain” and a loss of youthful and productive workers who might be needed for internal development processes in their home countries or towns.

Internal migration, however, does also exist in many parts of Africa. This is often seen as essentially rural-to-urban and contributing to uncontrolled growth and related urban management problems in many large cities. This has resulted in many policies to control or discourage migration. While migration restriction is infrequent, many countries have tended to make cities relatively inhospitable, for example by bulldozing informal low-income settlements, or making it difficult for new migrants to secure property rights to land or access to public services.

These measures generally have little impact aside from lowering welfare, especially for the poor. In fact, most of the growth in urban population is due to natural population increase. Despite widely-held beliefs that migration flows have tended to be rural-to-urban, the most recent data in Zambia shows that migration from urban to rural areas is increasing. This type of movement is often associated with economic decline and increasing poverty. In Zambia, significant numbers of retrenched urban workers during the decade of the 1990s were thought to return to rural ‘home’ areas, where the cost of living was lower.

Overall, migration patterns reflect spatial imbalances in growth and poverty trends within the country and across the region.



Study questions and problems

1. Explain how the demand for labour is derived from the product that labour helps produce.
2. How does the value of the marginal product for labour relate to the hiring decision for a firm?
3. Draw a figure showing how the intersection of the market demand curve for labour and the market supply curve of labour determines the equilibrium wage rate and employment level. How are the equilibrium wage rate and employment level affected by:
 - An increase (decrease) in the market supply curve of labour?
 - An increase (decrease) in the market demand curve for labour?
4. What effect does an increase in the market supply curve of labour have on the wage rate and the quantity of labour demanded? How about an increase in the market demand curve for labour?
5. Explain how a firm determines the quantity of workers demanded?
6. Identify the advantages and disadvantages of a minimum wage law that raises the wage rate above the market equilibrium level. Why is a minimum wage necessary in the context of the African labour market?
7. Describe the methods used by trade unions to increase the wages of their members.
8. What are the factors that underlie the ability of a trade union to increase the wages of its members?
9. Explain the different kinds of unemployment. What policy options are available to tackle the problem of unemployment in Africa?
10. What do economists mean by “inflation”? How is the rate of inflation calculated? What are the main causes of inflation?
11. Explain why domestic workers, say in a country like South Africa, may be apprehensive about liberal immigration policies.

Review questions

1. Explain how the demand for labour is derived from the product that labour helps produce.
2. How does the value of the marginal product for labour relate to the hiring decision for a firm?
3. What effect does an increase in the market supply curve of labour have on the wage rate and the quantity of labour demanded? How about an increase in the market demand curve for labour?
4. Explain how a firm determines the quantity of workers demanded?
5. Identify the advantages and disadvantages of a minimum wage law that raises the wage rate above the market equilibrium level.
6. Describe the methods used by trade unions to increase the wages of their members.
7. Explain the different types of unemployment.

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PART III: African political economy

Unit 5: Key principles of political economy

“When the missionaries came to Africa they had the Bible and we had the land. They said, ‘Let us pray.’ We closed our eyes. When we opened them we had the Bible and they had the land.”

Bishop Desmond Mpilo Tutu, South African cleric and activist who rose to worldwide fame during the 1980s as an opponent of Apartheid. Awarded the Nobel Peace Prize in 1984 (born 7 October 1931)



Daily Nation, 3 September 2002. <http://www.gadonet.com>

Topics

1. What is political economy?
2. What is power?
3. Stages of the African political economy
4. Slavery
5. Colonialism
6. Neo-colonialism
7. Globalization

5.1 What is political economy?

The term “political economy” is derived from the Greek terms *polis* (city or state) and *oikonomos* (one who manages a household).

Political economy is the study of the relationship between individuals and society and between markets and the state, using methods drawn from economics, political science, and sociology.

Political economy is, thus, concerned with how countries are managed, taking into account both political and economic factors. The field today encompasses several areas of inquiry, including the politics of economic relations, domestic political and economic issues, the comparative study of political and economic systems, and the study of international political economy.

One can, therefore, say that political economy is the politics of the economy and the economics of politics. The political economy of a community, country, region or continent can be seen as shifting positions depending

on the development process that is taking place. As societies became more complicated in the manner in which politics and economics played each other out, so did political economy. To understand the political economy of the current world context, it is important to have an amount of historical insight. It is in this regard that we know a field of enquiry commonly regarded as economic history.

Link between politics and economics

Classical political economy encourages people to think that non-human inputs into the value-chain or the value creation process are more valuable than the human factor (labour). Advances in technology have led to massive lay-offs of labour—leading analysts to fuel the notion that labour can be done away with completely as part of the productive equation. Union leaders are often told that if they do not reign in labour militancy, many jobs will be lost and that the country's economy will not be able to compete globally. This is against evidence that the leading global leaders in the economy—Europe, America and Japan—have very strong unions and labour legislation. This takes us back to the way the international world economy is structured. Also, the continuous assault against labour in the wealth creation process has long-term consequences on capitalism—as the consumptive role of workers is undermined.

5.2 What is power?

Power is an important, universal dimension of all social relations. Power affects and defines many aspects of our daily lives: who we are, where we live, what language we speak, what type of lifestyle we lead, how and when we express ourselves. It determines who has the ability to do what, when and to whom. It distinguishes leaders from followers. It determines who makes the rules, and how far these rules will be obeyed. It can even make us do what we do not really want to do, such as pay taxes.

But how are we to understand power? We noted that politics is about the distribution of power. One respected commentator on South African politics said that:



“power is a central concept in the social sciences. It is configurations of power that determine how a society develops in the way that it does, and it is these configurations that fundamentally determine how that society actually functions”.

We may define power in the most basic sense as ‘the ability to do something’. For example, you have the power to fulfil the requirements of the courses for which you are registered. But there is a further, more complex meaning of the concept of power: ‘Power over’. In this sense, power is the ability of a person or a group of people to influence or force others to do what they might not want to do, for example to obey certain laws. When we talk of the state, it is more often this second meaning that we have in mind when we discuss power; power enables governing bodies to enforce rules and make individuals, groups, or other governing bodies do what they would really rather not do.

Sources of power

Where do people or groups get their power? We can identify a variety of sources:

Economic power comes from the control of necessary resources, how they will be used and so on. Those with economic power will be able, for example, to decide how much they pay their workers and what kinds of conditions the workers will have. They may, of course, have the power restricted by legislation, or by trade unions, but they still wield a great deal of it. The way in which social classes are organized derives from the distribution of economic power.

Personal power is the ability to control or influence people based on relationship, status, personality or mental ability. Mahatma Gandhi, for example, had few personal possessions and little physical power, but gained tremendous influence through his charismatic nature and integrity.

Psychological power is linked to persuasion, and involves convincing others to do something by appealing to their mind. The entire advertising industry depends upon the creative ability of copywriters to convince us through songs, images, sounds and other means that we need to buy a particular product. Governments rely heavily on appealing to citizens' sense of duty and obligation especially in times when war threatens.

Physical power or coercion is a 'last resort' source of power. It usually, but not always, refers to the threat of physical forces, which can cover a range of possibilities from being arrested and deprived of basic rights to being dispersed by rubber bullets, to having the full military might of the state called upon to deal with a crisis. Physical force can often decide the outcome of a conflict when all other means have failed to resolve it. That is why state monopoly of coercion is so powerful a weapon that those who are subjected to coercion have very little or no choice over whether to accept the conditions of those using force. However, governments that have no resort to physical power suffer a fundamental weakness. Coercion implies that there is a lack of consent, a lack of support for the holders of political power. As the Apartheid rule in Africa showed, no government can rule indefinitely using brute force alone. Political power derives from the holding of public office. Very often, those who become political leaders need a considerable amount of personal power.

“African nationalism is meaningless, dangerous, anachronistic, if it is not, at the same time, pan-Africanism”

Julius Kambarage Nyerere, First President of Tanzania, known by the Kiswahili name Mwalimu or 'teacher' (1922-1999)

5.3 Stages of the African political economy

Africa has gone through four stages of penetrations by outside forces, which have had negative social consequences for Africa's people and development: slavery, colonialism, neo-colonialism and globalization.

Slavery

Historians tell us that until about 4000 BC, virtually all Africans were hunters/gatherers. Hunting and gathering were seen as a 'mode of production'. They further tell us that in the first thousand years after Christ, there was evidence in a number of parts of Africa of the emergence of larger political units under Kings, showing that a process of state formation had occurred.



Activity: Discussion forum

Some people argue that colonialism gave Africa a kick-start into the industrialization mode that Europe and America had already begun, while others argue that in fact, colonisation completely derailed Africa from the path of development.

Discuss any possibility that Africans could take advantage of colonialism.

Colonialism

In the late 19th century, the “Scramble for Africa” (rush for territorial control in Africa by European powers) resulted in the rapid subjugation of virtually the entire continent as colonies of Europe. Through this process, African economies ceased to exist as independent entities producing towards the advancement of their own people. Instead, they were appended to the imperial effort in which the key features involved the alienation of land and the ‘partial’ proletarianization of the African people—albeit in a controlled social space marred by racial segregation.

Reasons for partitioning of Africa

Extract from T. Rowell (1986), The Scramble for Africa, London: B. Batsford, pp. 2-10

In 1870, Europeans controlled only 10 per cent of the African continent, most of it on the coast. By 1900, 90 per cent of it was partitioned, carved out with little regard for geography or for African people. Between 1878 and 1914, European powers took nearly 18 per cent of the world's land surface—quarter of a million square miles per year. By 1914 they controlled 80 per cent of the world's population. It was a mad “scramble”, and Africa was at the centre.

So why did they do it? You might at least expect that contemporaries knew. But this was not the case. Lord Salisbury recalled that in 1880 “nobody thought about Africa” but on becoming Foreign Secretary in 1885 complained, “I do not know exactly the cause of this sudden revolution, but there it is!” Cecil Rhodes the S. African millionaire declared that he was motivated by “Philanthropy-plus 5%”. Others pointed to “Commerce, Christianity and Civilization”. Looking back, there was a range of motives, which can be divided into six.

1. Strategic: Strategic motives were important. France’s interest in Tunisia arose partly because of its commanding position in the Mediterranean Sea. And it was the Suez Canal route to India, which dictated Britain’s interest in Egypt.

2. Political: Political motives also played a part. Bismarck imagined that taking empires won votes in elections, and saw colonies partly as bargaining counters in his European power game.

3. Economic: Economic motives, too, seem constantly to be present. King Leopold II of Belgium sent Stanley to explore the Congo (Zaire) in the hope of riches, and it was trading companies who pressed governments to intervene in Nigeria, Kenya and Tanganyika (Tanzania). The liberal economist J. A. Hobson (1858-1940) expressed strong disapproval in his *Imperialism: A study* (1902). For him, greedy capitalists invested profits made at home in far off places, and then persuaded European governments to foot the bill for armies to defend them. It was a monstrous “confidence trick”. The communist leader Lenin argued along similar lines (*Imperialism: the Highest Stage of Capitalism*, 1917) that having exhausted the resources and markets of Europe, capitalists competed for what remained overseas—until finally, fighting amongst them became inevitable (a theory which he claimed to be proved by the First World War 1914-1918).

4. Civilizing: But many Europeans talked of ‘civilizing’—exporting what they confidently believed to be superior values. Article 6 of the Berlin West Africa Conference’s General Act (1885) bound “all the powers...to watch over the preservation of the native tribes and care for the improvement...of their moral and material well-being, and to help in suppressing slavery.” Kaiser Wilhelm II arrogantly announced (1901) his “... innermost belief that the moral and spiritual salvation of mankind is bound to a powerful Germany stretching far across the earth...Today God relies on the Germans.” The English and French expressed similarly breathtaking sentiments. For Rudyard Kipling (1865-1936) it was Europe’s duty to “take up the White man’s burden”, a thankless but indispensable task to bring “improvement” and “justice” and “law”.

5. Demographic: For others, like the Italians, there was a “demographic” motive: their growing population (24 million in 1850, 34 million in 1900) was in need of space. What better than to find a “place in the sun” for the surplus? Some Englishmen talked of anarchy at home if colonies were not founded.

6. Prestige: Finally, empires brought prestige. They were something to show your neighbours. And the historian Guiliano Procacci suggests that King Umberto I sought colonies “... to convince the Italians that Italy was a great power, and so to surround with a halo of prestige a state that would otherwise have had little.”

Whatever the reason, of central importance was the conference at Berlin in 1884-5. Leopold II and the Portuguese government disputed control of the rich Congo (Zaire) trade and its outlet to the sea. At the conference, it was agreed that any claims to a region would only be recognized by the great nations if real authority were being exercised there. It was like firing a gun to start a race. Impelled by these new “rules of the scramble”, nations rushed to agree “spheres of influence” over areas of which they know nothing, drawing nonsensical straight lines on the [empty] map. Then nervous of apparent industrial depression at home, they raced to stake their claims, taking sudden interest in European traders and adventurers there whom they had previously ignored. The history of Africa, then, can be broadly divided into before and after the Berlin Conference.

Neo-colonialism

One of the most important features of colonialism was that it integrated the colonies into the international capitalist economy. Colonial rule in Africa began to weaken after World War II after centuries of colonialism. More than 40 countries gained independence from European powers between 1957 and 1973 as strong nationalist and anti-colonial sentiments swept through large parts of Africa. The first country to gain independence was Ghana in 1957 while Zimbabwe and Namibia became independent in 1980 and 1990, respectively.

However, this did not mean that the former colonial powers had no further interest in Africa and left the continent to design its own development strategy. Independence was achieved through a complex set of socio-economic forces that developed within African and the broader international system.

In the immediate post-independence period, various African states experimented with different models of economic development and planning. Policies pursued after independence ranged from African socialism to military nationalism. We explore some of these policies and examine their implications for development.

Figure 5.1: African independence



Generally, all newly independent governments in Africa had to deal with difficult problems relating to the disjointed structure of the colonies, people's high expectations for national development, and a lack of economic development. The colonial era left most African countries economically vulnerable and dependent on the markets of the former colonial powers.

The newly elected African leaders had sought to establish political and economic policies that would enable them to create strong unified nations and to improve the material well-being of their people. Such policies included "African Socialism", "African Capitalism" and "Military Nationalism". We will now briefly discuss the key features of these policies with reference to the countries and leaders that pursued these policies.



Daily Nation, 3 November 2005. <http://www.gadonet.com>

- **African Socialism** was adopted in various forms by Ghanaian leader Kwame Nkrumah, Ahmed Sekou Toure of Guinea, Modibo Keita of Mali, Gamal Abdel Nasser of Egypt, Julius Nyerere of Tanzania and Kenneth Kaunda of Zambia. Traditional African systems had changed dramatically during the colonial rule. It was, therefore, not possible for newly elected leaders to revert to traditional economic systems after independence. During the 1960s, philosophical debates over the meaning of African Socialism raged. One of the biggest questions was the following: Can African societies that did not have clearly defined social and economic classes, and did not mature as capitalist countries, move into socialist production?
- **African Capitalism** was the policy adopted by leaders such as Abubakar Tafawa Balewa of Nigeria, Hastings Kamuzu Banda of Malawi and Daniel arap Moi of Kenya. Leaders who adopted this policy did not fundamentally restructure the economies of their countries. Some leaders like Kenya's Jomo Kenyatta wanted to be "non-ideological" and rejected both Western capitalism and Eastern Communism. Instead, they stressed economic growth and prosperity by promoting material advancement, fostering entrepreneurship and attracting foreign investment. In Kenya, this was facilitated by heavy reliance on western advice and aid and thus constituted a continuation of capitalism.
- **Military Nationalism** was adopted by Idi Amin Dada of Uganda and Mobutu Sese Seko of Zaire. Most African governments inherited systems that were weakened and fragmented by colonialism. Consequently, military leaders, who were afraid that their countries would fall apart politically, strove to build a strong state, which could resist any threat of resistance. Most military leaders were dictatorial and justified their taking power by arguing that the previous civilian governments were not meeting the basic needs of the people. However, rulers like Mobuto Sese Seko directly served western imperialist interests and facilitated the continuous plunder of resources by transnational companies (TNCs).

Globalization

The term "globalization" was first coined in the 1980s, but the concept stretches back decades, even centuries, if you count the trading empires built by Spain, Portugal, Britain, and Holland. However, in reality, there is no universal definition of globalization. It means different things to different people.

In its literal sense, globalization is the process of transformation of local or regional things or phenomena into global ones. It can also be used to describe a process by which the people of the world are unified into a single society and function together. This process is a combination of economic, technological, socio-cultural and political forces.



Myth 5: Globalization is inevitable

Advocates of globalization try to describe it as an inevitable process, the logical outgrowth of economic and technological forces that evolved over centuries to their present form, nearly as if they were forces of nature, like gravity. But while global trade activity and concepts of free trade have existed since the distant past, they do not nearly begin to resemble the volume, speed, form or impact of today's activities, nor were they as deliberately plotted and structured.

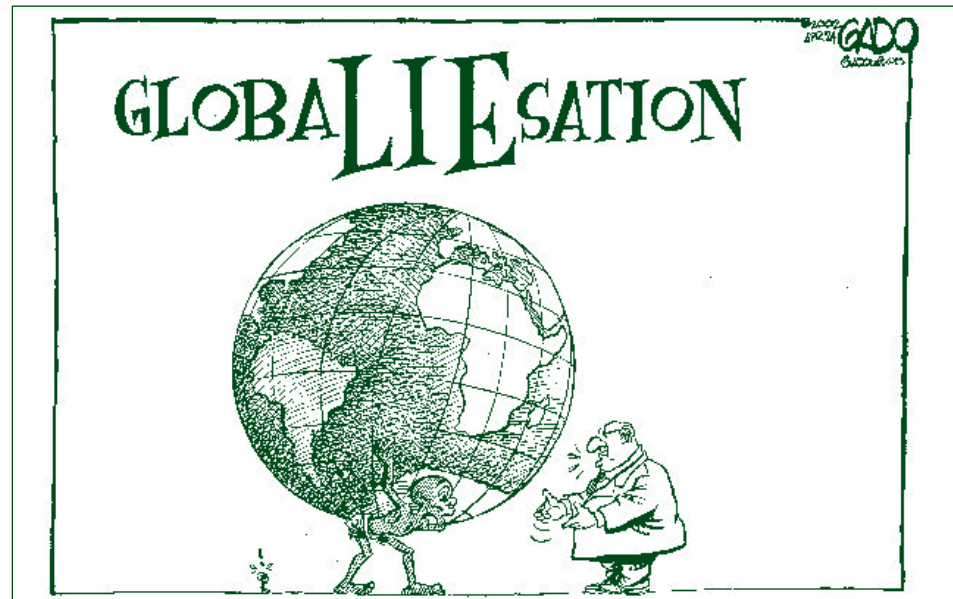
Economic globalization in the modern era is not some kind of accident of evolution; it directly emerges from a set of institutions and rules created on purpose by human beings for a specific goal: to give primacy to certain economic processes and values, and place them above all others.

In fact, modern day globalization had a birth date and a birth place: Bretton Woods, New Hampshire, July 1944. That is when the world's leading economists, bankers, corporate heads, and heads of western governments tried to create a new economic system, following the devastation of World War II. They decided on a globally centralized system with global corporations as the engines of economic growth.

New institutions were created with new rules and powers to help grease the pathways for the corporations. Out of the Bretton Woods meeting grew instruments that later became the World Bank, the International Monetary Fund (IMF), the General Agreement on Tariffs and Trade (GATT), the North American Free Trade Agreement (NAFTA), and now the World Trade Organization (WTO).

The primary function of these bodies is to place economic values above all others, and to establish rules that suppress the ability of nation-states to sustain laws that protect nature, workers, consumers and even national sovereignty and democracy if they can be construed as slowing down free trade. The net result is the greatest transfer of economic and political power from nation-states to corporations ever in history.

But none of it is inevitable. All of it can be reversed once citizen movements and their governments realize the full consequences. To call what is essentially a collection of rules—very consequential rules—"inevitable," is really designed to make everyone feel there is nothing to be done about it, thus promoting passivity.



Daily Nation, 24 April 2002, <http://www.gadonet.com>

Personal views on globalization from Africa

Mr Bokuku:

According to me, globalization refers to a global village. The idea was born in western countries, and is conditioned by the USA. The idea is to bring the people into an economic and political bloc, where they bring the idea of equality between nations and people. I do not trust globalization...I define it as the continuation of oppression, the top of imperialism.

Mr Kilimangongo:

Referring ourselves to the history, the word "Globalization" appeared first in the US, in a thesis of an economics student at the University of Chicago. According to him, the world is divided economically. Despite these differences, we should agree strongly on the measurements, terms and forms. Let the world in its inventions have the same measurements, terms and shapes.

The true meaning of the thesis was in the economic context. The first country to say "no" to globalization was USSR, and we all know what befell it.

Mrs Mami Bahati:

To sustain globalization in its economic context only and reject it in other aspect seems to be a contradiction, because the economic context is at the core of the strength of globalization. Actually, the countries that are economically strong are the ones ruling politics, diplomacy, and defence... in the world.

Therefore, globalization in the economic context is the most redoubtable face of globalization. That is the part we have to

correct. We want to assure and warrant the participation of all countries at the same level. Without that, globalization stays an utopia.

Mr Muhoho:

In our search to define the meaning of globalization, let us not forget our past as Africans. Globalization is an extension of the more than 800 years of slavery, colonization, neo-colonialism and imperialism. Globalization uses various strategies, like religion, to confuse people.

Source: <http://news.bbc.co.uk/2/hi/business/1796890.stm>

Beyond the definitions, we all know that globalization is a reality that, for better or worse, touches our lives in ways most of us never stop to think about. Many would certainly say it was a good thing. Increased international trade has made us wealthier and allowed us to lead more diverse lifestyles. It has brought diminishing national borders and the fusing of individual national markets. The fall of protectionist barriers has stimulated free movement of capital and paved way for companies to set up several bases around the world. The rise of the Internet and recent advances in telecommunications has boosted the already surging train. For consumers and avowed capitalists, this is largely a good thing. Vigorous trade has made for more choice in the High Street, greater spending, rising living standards and a growth in international travel.

At the same time, the legions of demonstrators amassing at every opportunity of the annual meetings of the International Monetary Fund and the World Bank disagree. The coalition of environmentalists, anti-poverty campaigners, trade unionists and anti-capitalist groups see the growth of global companies as raising more problems than it solves.

Critics say the West's gain has been at the expense of developing countries. The already meagre share of the global income of the poorest people in the world has dropped from 2.3 per cent to 1.4 per cent in the last decade. But even in the developed world, not everyone has been a winner. The freedoms granted by globalization are leading to increased insecurity in the workplace.

Manual workers, in particular, are under threat as companies shift their production lines overseas to low-wage economies. National cultures and identities are also under threat, thanks to the spread of satellite TV, international media networks and increased personal travel. In French cinemas, around 70 per cent of filmgoers watch Hollywood movies.

Economists hoped that sub-Saharan Africa would benefit from the opportunities brought by globalization. However, as the World Bank and the UK's Department for International Development (DfID) have acknowledged, the benefits of globalization are not being passed on to Africa.¹ Africa's share of world trade fell from more than 3 per cent in 1950 to 1.2 per cent (excluding South Africa) in the mid-1990s. Africa captures only 0.9 per cent of world investment, most of which flows to mineral-rich

¹ World Bank 2000. DFID 2000. White paper on globalization.

areas. Rather than provide the answers to Africa's ills, globalization may have exacerbated the problems through rigged trade rules, inappropriate investment and collapsing commodity prices. Many African governments now find that they are powerless to control economic dynamics in their own countries, because the levers of economic and political governance are international in dimension and beyond their control. Average living standards have risen everywhere else in the world except in Africa, where they have fallen by 20 per cent over the same period. Africa appears to be running against the current of the powerful forces driving world trade and globalization.

Large flows of unethical investment and illegal trade in minerals, natural resources, and arms have gone unrecorded and unregulated. To millions of Africans, the continent's abundant natural resource base may seem more of a curse than a blessing. Investment and trade in extractive industries in the Democratic Republic of Congo (DRC), Sierra Leone, Angola, and Sudan have generated war economies that profit international companies or armed political elites, while undermining long-term economic growth.

The following are some of the challenges of globalization on African workers:

- Businesses are expected to produce more output with fewer workers, because of competition
- Longer working hours or extra shifts have been introduced without any pay increase
- Redundancies after "downsizing"
- Threats by management on relocation of production if labour costs cannot be reduced
- Workers not allowed to form or join a trade union
- Increased competition has widened income differentials in industrialized countries
- There has been growth of precarious forms of work and less job security
- Attacks on the social security system
- Erosion of collective bargaining and trade union influence

Cheerleaders of globalization

Centre for Free Trade Policy:

Run by the Cato Institute to "...increase public understanding of the benefits of free trade and the costs of protectionism."

Freedom Network:

Examines globalization from a market-oriented perspective. The editor writes, "So globalization helps to make people more wealthy and nations more free. Who could oppose these things?"

Going Global:

Exists for newbies to global business and the Internet.

Global Envision:

"Global Envision believes that the more that we understand about the free market system, how it affects us and our neighbours all over the globe, and how it can benefit us all, the better our chances that the global economy will thrive for the prosperity of all."

Globalization and Neoliberalism:

An economic professor discusses the benefits of globalization.

International Chamber of Commerce:

This world business organization promotes an open international trade and investment system and the market economy.

TradeNet:

Run by the US Small Business Administration and other agencies, summarises government support for American businesses looking to trade overseas.

World Trade Organization:

This is the leading government-membership group leading the move towards global integration.

Stringent opponents of globalization

Challenging Globalization:

A book from the American Friends Service Committee, a Quaker organization.

CorpWatch:

Offers index of globalization and corporate rule.

US Network for Global Economic Justice:

The organization works to make international financial institutions accountable to those who have to live with the effects of their policies and practices.

Global Exchange:

Details concerns about globalization.

Globalization in Focus:

Foreign Policy in Focus says they are, "Working to make the US a more responsible global leader and partner."

Global Solidarity Dialogue:

A great collection of articles and resources by independent writer/researcher, Peter Waterman.

Global Trade Watch:

This project of Public Citizen promotes government and corporate accountability.

Mobilization for Global Justice:

Website for organizing protests against major global economy meetings and events.

World Bunk:

This World Bank parody site has adopted Groucho Marx as its spokesman--some rare humour in the protest movement (The World Bunk. Not World Bank, World Bunk).



Quiz on globalization

1. The 1999 anti-globalization protests in Seattle surrounded what international meeting?
 - A. United Nations
 - B. International Monetary Fund
 - C. World Trade Organization
 - D. World Wrestling Federation

2. In 2003, an anti-globalization protester killed himself during the WTO meeting in what city?
 - A. New York City
 - B. Honolulu
 - C. Genoa
 - D. Cancun

3. According to the 2003 *Foreign Policy Magazine* Globalization Index, what is the most globalized country in the world for the second year in a row?
 - A. Ireland
 - B. United States
 - C. Sweden
 - D. Malaysia

4. When asked to rate globalization overall, what per cent of Americans gave globalization a “positive” rating?
 - A. 73
 - B. 53
 - C. 3
 - D. 13

5. According to the UN’s Human Development Report, Norway has the world’s highest life expectancy rate, 78.5 years. What is the life expectancy in Sierra Leone, the lowest country?
 - A. 68.9
 - B. 58.9
 - C. 48.9
 - D. 38.9

6. The 2003 *Foreign Policy Magazine* Globalization Index has ranked the United States as the ____ most globalized country in the world.
 - A. 2nd
 - B. 11th
 - C. 22nd
 - D. 34th

7. According to the United Nations Development Programme, how many people in developing countries die each year from diseases associated with unsafe drinking water, inadequate sanitation and hygiene?

- A. 32.2 million
- B. 22.2 million
- C. 12.2 million
- D. 2.2 million

8. According to the 2003 Human Development Report, ____ poor countries actually got poorer over the last decade.

- A. 54
- B. 44
- C. 64
- D. 34

9. The average income for the richest twenty countries in the world was 15 times the average for the poorest twenty countries in 1960. What is it now?

- A. 5 times
- B. 10 times
- C. 20 times
- D. 30 times

10. In 2000, the United States was ranked the third richest economy in the world, based on its \$34,100 Gross National Income (GNI) per capita in Purchasing Power Parity (PPP) terms. What was the GNI per capita in PPP terms in the country ranked as the poorest, Sierra Leone?

- A. \$480
- B. \$1,500
- C. \$3,340
- D. \$5,680

Answers: 1.C; 2.C; 3.D; 4.D; 5.D; 6.C; 7.B; 8.A; 9.D; 10.A.

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Unit 6: Contemporary issues in African political economy

Topics

"Those who invest in South Africa should not think they are doing us a favour; they are here for what they get out of our cheap and abundant labour, and they should know that they are buttressing one of the most vicious systems."

Bishop Desmond Tutu, African spiritual leader and novelist (born 1931)

1. Africa's development potential and challenges
2. Search for development strategies for Africa's potential
3. Obstacles to Africa's economic development
4. Making development agenda work for Africans



Daily Nation, 15 February 2003, <http://www.gadonet.com>

6.1 Africa's development potential and challenges

"Seek ye first political kingdom, and all things shall be added unto you" (Nkrumah, 1957:164)

Kwame Nkrumah, First President of Ghana, one of the most influential Pan-Africanists of the 20th century (1909-1972)

Africa is the world's second largest continent after Asia, with a total surface area, including several surrounding islands, of over 30 million square kilometres. Africa has 54 independent countries—48 mainland and 6 island states—with an estimated total population of 850 million. While many write off Africa as the continent of despair, other enterprising individuals and organizations have recognized the huge, untapped potential of Africa and are actively pursuing business ventures across the continent.

Africa produces more than 60 metal and mineral products and is a major producer of several of the world's most important minerals and metals, including oil and gas, gold, diamonds, uranium, manganese, chromium, nickel, bauxite and cobalt. Although under-explored, Africa hosts about 30 per cent of the planet's mineral reserves, making it a truly strategic producer of these precious metals (Table 6.1).

Table 6.1: Africa's share of world reserves

Reserves	% Africa's share	Reserves	% Africa's share
Diamonds	96	Gold	50+
Chromium	85	Thorium and	
Platinum	85	Uranium	30
Cobalt	55	Traded oil	20
Manganese	40	Cocoa	70
Bauxite	40	Hydroelectric	
Copper	13	potential	27
Phosphate	50	Oil palm	50
Coffee	33		

Source: ICFTU-AFRO 2005.

Countries such as the Democratic Republic of Congo, Ghana, South Africa, Tanzania, Zambia, and Zimbabwe dominate the African mining industry, while Angola, Botswana, Namibia, Sierra Leone and Zambia depend heavily on the mining industry as a major foreign currency earner. Substantial oil reserves are also found in Angola, Cameroon, Chad, Congo, Equatorial Guinea, Gabon, Libya, Nigeria, Sao Tome and Principe, and Sudan. Unfortunately, several African civil wars are funded, and often caused by some of these commodities, in particular diamonds. Major recent discoveries include the discovery of several potentially diamondiferous kimberlites in Mauritania, and marine deposits of diamonds in offshore southern Namibia.

The eastern region of Africa is home to the great wildlife reserves of the Serengeti and Masai Mara plains and the Rift Valley lake system. The Horn of Africa boasts of the source of the longest river in the world, the Nile River, which flows northwards over 6,690 kilometres to end in the Mediterranean Sea.

Perhaps Africa's greatest opportunity lies in its biodiversity, which ranges from the Sahara desert to tropical jungle, from snow-capped volcanic Mount Kilimanjaro and Mount Kenya to the beaches of East and West Africa. Then there is the excitement of stalking big game in the African bush to the thrill of white-water rafting through the gorges below Victoria Falls or the awe of seeing the Egyptian pyramids at sunrise.

6.2 Search for development strategies for Africa's potential

Africa's development "visions"

Since the last century, African leaders—both in the diaspora and in the continent—began to view the continent as a whole instead of as fragmented pieces. They also began to discuss continental development as opposed to piecemeal development of specific countries or a specific region of the continent. These views of the continent were slowly incorporated into the nationalist struggle and eventually received their clearest articulation during the struggle for independence. The Pan-African Congress held in Manchester (in 1945), which brought together African nationalist leaders as well as leaders from the diaspora, gave the clearest expression of Africa's vision: (a) to achieve independence from colonial rule throughout the continent so that Africans can rule themselves democratically; (b) to achieve continental unity so that Africa can: (i) bring about faster economic growth and development to catch up with the industrialized countries, and (ii) so that Africa can be strong within the international system.

This vision was popularized at the sub-regional level as nationalist movements mobilized the peasants and workers for the struggle against colonial rule. And the nationalist movements achieved their independence on the basis of this vision.

When the Organization of African Unity (OAU) was created in 1963 in Addis Ababa, it incorporated in its Charter the vision for Africa as follows:

- achieving independence from colonial rule so that Africans can rule themselves democratically, and
- achieving continental unity so that Africa can bring about faster economic growth and development to catch up with the industrialized countries, and be strong within the international system.

Independent African countries added to this vision several other elements such as eradication of poverty and disease, self-reliance and equity. It is fair to say that in the 1960s, most African countries proclaimed and propounded this vision.

However, before the end of the 1960s, there appeared a major division of African countries into two groups: the Monrovia and the Casablanca blocks. The Monrovia block adopted a more radical vision of the future of Africa, giving credence to faster continental political unity, self-reliance and equity, with socialism being the main path to development. The Casablanca block, on the other hand, had a less radical vision that ignored the issues of equity and self-reliance but emphasized nation-building and a development path through *laissez faire* and open market.

Africa and the Cold War

The 1970s Cold War seriously affected African countries, many of which were forced to take sides in the ideological war. While in the 1970s African countries were not organized or associated into blocks such as the Monrovia and Casablanca, they were nevertheless deeply divided between those that were Socialist, Marxist and “Capitalist”. The Socialist countries were heavily influenced by the social democratic vision of the Scandinavian countries, the Marxist and Capitalist countries were effectively influenced by the Soviets and American-led Western visions of development, respectively.

Irrespective of the ideological path, most African countries actually experienced rapid growth in the 1960s and early 1970s. During the 1960-75 period, Africa grew at a rate of 4.5 per cent, while exports, agriculture and manufacturing grew at 2.8 per cent, 1.6 per cent and 6 per cent, respectively. Unfortunately, the whole of the African continent was later on faced with various crises that saw it stagnate.

The OAU, and in collaboration with the United Nations Economic Commission for Africa (UNECA), mobilized African intellectual and political resources to discuss the crises and come up with a vision and a plan of action for getting Africa out of the crises and towards a better future. This serious effort led to the now famous Monrovia Declaration (1979), which articulated Africa’s vision of its future. Thus, even before the shock waves of the 1980s had struck, African leaders had seen the need for a long-term strategy for structural transformation.

This declaration was the African strategy for the Third United Nations Development Decade. The declaration ranked self-sufficiency in food and industrial development as the driving force for the emancipation of the continent. The declaration was also committed to, *inter alia*, “the development of indigenous entrepreneurial, technical manpower and technological capacities” to enable the African people assume greater responsibility in achieving rapid development.

The declaration provided the vision and scenario of Africa’s future. The Africa of 2000/2020 will “have a high degree of self-sufficiency, a democratic national development, which will distribute the fruits of our efforts more equitably, will have a strong African solidarity and that Africa will carry more weight in world affairs”.

Since then, plans to ‘rescue’ Africa have been so prolific that they can fill a school library. Most of these plans have achieved little except gather dust or remain reference materials for students. It has been observed that there have been more planning commissions on Africa than there have been military coups. No one, except for obsessive historians, remembers how many of these there have been.

The Council of Ministers of the OAU meeting in Lagos in April 1980 formulated a Framework for a Programme of Action for the African Industrial Development Decade (1980-1990). This programme was

adopted by the Heads of State and Government as the Lagos Plan of Action in 1980.

The Lagos Plan of Action provided the framework and strategies for implementing development programmes. It based its strategies on some important principles, which it considered will lead to an alternative form of development and will take Africa out of its crises. These principles were:

- Self reliance should be the basis of development at the national, sub-regional and regional levels;
- Equity in the distribution of wealth at the national level is a fundamental objective of development;
- Public sector is essential for development and it should be expanded;
- Outside capital is an unavoidable necessity and it should be directed to those areas where African capital is lacking or inadequate, such as mining, energy and large scale projects;
- Inter-African economic cooperation and integration is essential and should be effected as soon as possible; and
- Change in the international economic order to favour Africa and Third World countries is essential and Africa should continue to fight for New International Economic Order (NIEO).

On the basis of these principles, the Lagos Plan of Action gave primacy to the development of agriculture (first for food and then for export), industrialization (to satisfy basic needs), mining industries (to recover total and permanent sovereignty over national resources, establish mineral-based industries), human resources, and science and technology.

Conscious of the need to translate the development targets in the Lagos Plan of Action and the Final Act of Lagos, the Heads of State and Government proclaimed the 1980s as the Industrial Development Decade for Africa (IDDA). The main aim was to focus greater attention on the industrialization of Africa, and mobilizing greater political commitment, financial and technical support at the national, regional and international levels. IDDA was formally ratified at the international level by the United Nations General Assembly at its 35th Session.

The implementation phase of the IDDA programme (1985-1990) was focused on the local development of factor inputs. Special emphasis was given: to the promotion and realization of intra-African industrial cooperation; adjustment of industrial strategies, policies, plans and institutional infrastructure; development of core industries in metallurgical, engineering, chemical, building materials and capital goods industries and processing of local raw materials, development and promotion of small and medium-scale industries and entrepreneurship; development of human resources and technological capabilities for industrial development; mobilization of financial resources; and the enhancement of intra-African industrial cooperation.

Notwithstanding numerous development initiatives, most African countries experienced a series of serious setbacks since early 1980s, whose effect was to further adversely affect the rates of economic and social development. Many economists refer to this crisis as “structural”, although there are many causes (both internal and external) to the situation. The external factors, including repeated droughts, the continuing low level of commodity prices in real terms, and the growing burden of debt have played a significant part. Internal factors arising from inappropriate policies, institutional weaknesses, administrative shortcomings, and political instabilities also have a major responsibility.

Structural Adjustment Programmes and PRSPs



“When the IMF and the World Bank force a country to cut wages, lay off workers, produce for export instead of their own people, and sell off public property to cronies for less than its value, that is called “economic reform”

Anonymous

Daily Nation, 24 November 2003. <http://www.gadonet.com>

In a determined effort to re-accelerate the withered process of development and in response to the structural crisis, many countries of Africa adopted the now infamous Structural Adjustment Programmes (SAPs). These programmes, supported by international financial institutions (in particular, the International Monetary Fund and the World Bank) were aimed at reducing fiscal and monetary imbalances by curbing government expenditures and reducing the scope of public sector activities, exchange rate adjustment, price and import liberalization, institutional reform, and a greater reliance on market forces.

The IMF/World Bank-sponsored SAPs continued to be embraced by many governments in Africa for nearly two decades, with more disastrous implications to the economies. Of particular importance was the degeneration of living standards and economic recession caused by the massive devaluation of national currencies, reduced public spending, and higher external debt payments.

The fundamental problem of SAPs was that the IMF and the World Bank did not take into account the close connection between social development and economic policies and the need to establish a broad consensus over the purposes and timing of reforms through widespread consultation. These serious weaknesses were derived from:

- the prevailing ideology of market liberalization and financial stability;
- the prolonged period of crisis management associated with the debt crisis of the 1980s and the dramatic breakdown of centrally-planned economies in the 1990s;
- pressure from the major economic powers to achieve rapid changes with minimum transfer of resources; and
- the failure to coordinate policies between countries, including the largest industrialized nations, to ensure a high, stable and better balanced growth of the world economy.

The African Alternative Framework to Structural Adjustment Programmes for Socio-Economic Recovery and Transformation (AAF-SAF) originated from studies undertaken by UNECA and was originally presented as proposed framework in July 1989. The proposal was intended as an alternative to orthodox prescriptions of the Bretton Woods Institutions (World Bank and IMF) and its starting point was that Africa's development obstacles were not only economic, but political and social as well.

The draft was presented to the UN General Assembly in November 1989, but the United States voted against the resolution. As fate would have it, the AAF-SAF did not see the light of day as it was vehemently opposed and often roundly condemned by the World Bank, IMF and the donor community. Needless to say, the AAF-SAF was marginalized and eventually followed the fate of previous African initiatives.

Partly in response to the critique of many of their structural adjustment programmes, the IMF and the World Bank adopted new frameworks for their concessional lending to poor developing countries in September 1999. Henceforth, then country-owned (and not the IMF or World Bank-driven) poverty reduction strategies were to provide the basis of all concessional lending. This shift in overall policy goals implies that IMF and World Bank policies would have to move away from focusing exclusively on economic growth per se, but also deal with questions of distribution, access to resources and services in order to raise the living standards of the poorest members of society.

The expectation is that this strategy will be a decisive step towards more realistic and socially responsible policies by the Bretton Woods institutions. The invitation to trade unions and other civil society organizations to work with governments in the preparation, implementation and review of the Poverty Reduction Strategy Papers (PRSPs) is welcome. The PRSPs are now considered as the official policy documents with regard to economic and social policies.

The PRSP framework provides a new opening for trade unions to engage with their governments and demand a role in policy-making. It also gives unions a chance to work with NGOs and other elements of civil society and forge meaningful relationships with potential allies for future campaigns. Most importantly, the PRSP process represents another area where trade unions around the world can act in solidarity in pushing for pro-poor and pro-worker reforms in the global economy.

Millennium Development Goals and other international initiatives

In September 2000, world leaders adopted the Millennium Declaration. The Declaration covers issues of peace, security and development, including the environment, protection of vulnerable groups, human rights and governance. The Declaration consolidates a set of inter-connected development goals into a global agenda. These goals are designated as the “Millennium Development Goals” or “MDGs”:

1. Eradicate extreme poverty and hunger
2. Achieve universal primary education
3. Promote gender equality and empower women
4. Reduce child mortality
5. Improve maternal health
6. Combat HIV/AIDS, malaria and other diseases
7. Ensure environmental sustainability
8. Develop a global partnership for development

Each goal comprises numerical targets to be achieved by the year 2015. Appropriate indicators have been selected to monitor progress and the goals, targets and indicators must be considered as indicative for country-level monitoring.

The MDGs help to reinforce strategies to achieve other internationally agreed objectives reached at world summits and global conferences during the 1990s. They build on the outcomes of these conferences and will in many instances serve to monitor progress towards human development. MDGs do not undercut, in any way, internationally agreed human rights standards, while at the same time provide useful benchmarks against which progress in meeting human rights, employment and social protection can be measured.

MDG monitoring takes place at the global and country levels. At the global level, the UN Secretary-General reports annually to the General Assembly on the implementation of the Millennium Declaration. Every five years, the report will include a comprehensive review of progress towards the

MDGs. At the country level, MDG Reports or Reviews (MDGRs) are meant to help engage political leaders and top decision-makers, as well as to mobilize civil society, communities, the general public, parliamentarians and the media in a debate about human development.

We can identify two comprehensive initiatives by Africans themselves aimed at addressing the developmental challenges of Africa: the Lagos Plan of Action and the companion African Alternative Framework for Structural Adjustment. But it is also possible to note that at each time, these initiatives were counteracted and arguably undermined by policy frameworks developed from outside the continent and imposed on the continent.

What is observable is that whether the planning was Africa's own or derived from outside the continent, the initiatives have largely depicted ignorance on the democratization process and, in particular, of the expansion of space for citizen expression and participation. The planning processes have fallen short of acknowledging the contribution of citizen's struggles and activism.

Other existing initiatives on Africa include: the G8 Okinawa Declaration; the EU/ACP Cotonou Agreement; the EU/ACP Cairo Plan of Action; the US Government's African Growth and Opportunity Act (AGOA); Japan's Tokyo International Conference on African Development (TICAD); and British Africa Recovery Plan.



Daily Nation, 28 June 2002, <http://www.gadonet.com>

New Economic Partnership for Africa's Development

The latest proclaimed African initiative, the New Partnership for Africa's Development (NEPAD) was developed in the same period as the United Nations Economic Commission for Africa's "Compact for African Recovery," as well as the World Bank's "Can Africa Claim the 21st century?" Based on past experiences, African leaders have noted that peace, security, democracy, good governance, human rights and sound economic management are preconditions for sustainable development. In this regard, the leaders have accepted the responsibility of addressing these issues and, through NEPAD, pledge to work individually and collectively to promote these principles in their countries, sub-regions and the continent.

NEPAD is a programme of the African Union designed to address the current challenges facing the African continent, such as the increasing poverty levels, under-development and the continued marginalization of Africa. The proponents of NEPAD regard it as a holistic, integrated strategic development plan to enhance growth and poverty reduction in Africa by addressing key social, economic and political priorities in a coherent and balanced manner. It is seen as a vision for Africa, conceived and developed by African leaders. It is also a framework for new partnerships with the rest of the world to accelerate the integration of the African continent into the global economy.

Principally, NEPAD is a merger of two new initiatives that had emerged at the dawn of the new millennium as visions for Africa's long-term development. These are the Millennium Partnership for the African Recovery Programme (MAP), proposed by Presidents Abdelaziz Bouteflika of Algeria, Olusegun Obasanjo of Nigeria, and Thabo Mbeki of South Africa; and the OMEGA Plan, proposed by President Abdoulaye Wade of Senegal. A third framework, the Compact for African Recovery (CAR), had been developed by the UN Economic Commission for Africa (UNECA) as a technical input to the elaboration and implementation of a consolidated Plan for Africa. NEPAD and AU initiatives were unanimously adopted by African leaders in July 2001 at the OAU Summit in Lusaka.

The priority areas of intervention to achieve the NEPAD goals and objectives are summarized as:

- Peace, security, democracy and political governance;
- Economic and corporate governance;
- Regional co-operation and integration;
- Infrastructure;
- Human development;
- Agriculture and environment; and
- Market access and export diversification.

An important innovation introduced by NEPAD is the peer review mechanism by which African leaders pledge to undertake self-examination individually and collectively for good economic and political governance.

6.3 Obstacles to Africa's economic development

“The question as to whom and what is responsible for African under-development can be answered at two levels.

Firstly, the answer is that the operation of the imperialist system bears major responsibility for African economic retardation by draining African wealth and by making it impossible to develop more rapidly the resources of the continent. Secondly, one has to deal with those who manipulate the system and those who are either agents or unwitting accomplices of the said system”

*Walter Rodney,
prominent
Guyanese
historian and
political figure
(1942-1980)*

Recent economic trends show that Africa was the second fastest growing developing region behind eastern and southern Asia. Africa's performance was underpinned by rising prices of oil and other commodities, an increase in foreign direct investment (FDI) and good macroeconomic fundamentals, backed by improved weather conditions. As a result, real GDP grew at 3.8 per cent in 2003. These signs of progress are encouraging, although they fall short of the continent's urgent need for much more rapid growth. Unfortunately, Africa is still a long way from achieving the 7 per cent growth that is required to meet the principal Millennium Development Goal (MDG) of halving poverty by 2015.

Africa's development is hampered by two inter-related sources: (a) hostile international economic and political order; and (b) inherent domestic weaknesses.

(a) Hostile international economic and political order:

- Depreciating terms of trade derived from the fact that African economies are integrated into the global economy as mere exporters of primary commodities and importers of manufactured products.
- Misguided policies of liberalization, privatization and deregulation as well as an unsound package of macroeconomic policies imposed through structural adjustment conditionality by the Bretton Woods Institutions and now institutionalized within the World Trade Organization (WTO).
- Unsustainable and unjustifiable debt burden.

(b) Inherent domestic weakness:

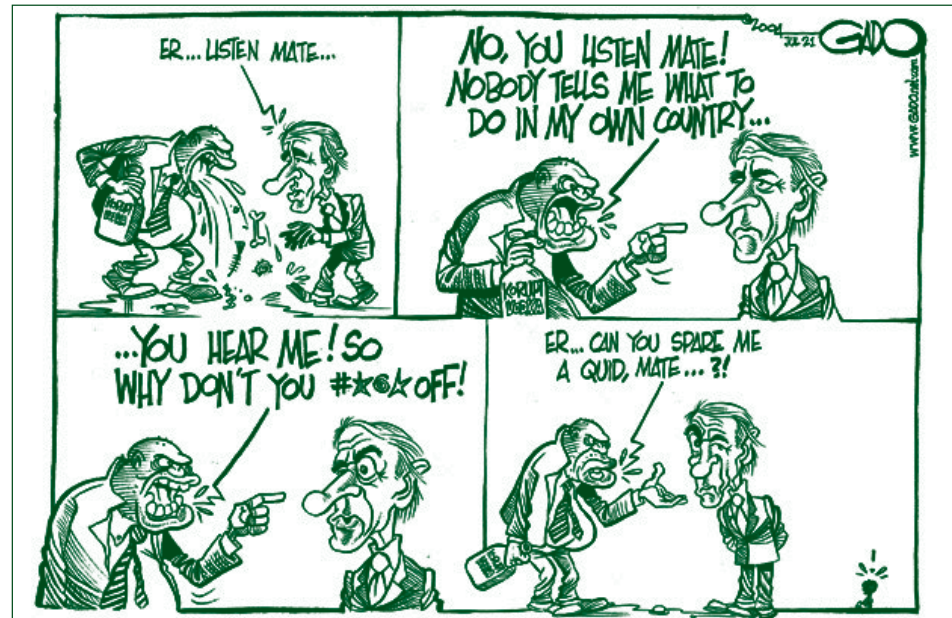
- Exacerbated by the hostile global order, the internal structural imbalances of African economies have led to the disintegration of social fabric of the continent.
- Lopsided neo-liberal structural adjustment policies, and inequitable socio-economic and political structures have destroyed the industrial base, while agricultural production, public services, and the capacity of states and governments in Africa to make and implement policies in support of balanced and equitable national development has been emasculated.
- Workers, peasants, small and indigenous producers, women and children have borne the entire burden, worsening the social capital of the continent.

6.4 Making development agenda work for Africans

(a) Africa must seize its potential opportunities to promote growth

“I dream of the realization of the unity of Africa, whereby its leaders combine in their efforts to solve the problems of this continent. I dream of our vast deserts, of our forests, of all our great wildernesses.”

Nelson Mandela,
South African
Statesman, first
democratically
elected State
President of
South Africa
(1994), 1993
Nobel Prize for
Peace
(born 1918)



Daily Nation, 21 July 2004, <http://www.gadonet.com>

The development challenges facing the African continent are enormous, and require not a simple solution. Prospects for Africa are not promising, with tens of millions barely surviving in a degrading and debilitating poverty. There is, therefore, the need for an integrated holistic approach. Africa has to adapt to this process and seize the potential opportunities that exist for the economic and social progress of the continent and its integration in the global economy. In that respect, the success of this adaptation depends, to a large extent, on the actors and the countries themselves. To achieve these objectives, African countries should create the necessary conditions for a conducive environment to boost economic growth, create employment and promote development.

(b) Employment challenge in Africa

<http://www.gadonet.com>

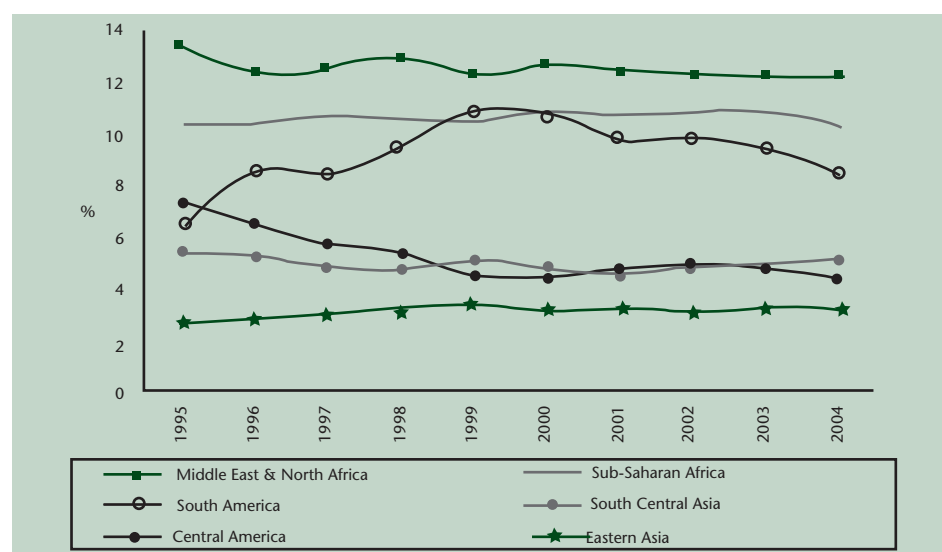
According to the ILO's African Employment Trends (April 2007), Africa had an estimated 331 million people employed in 2006, and its employment-to-population (EP) ratio was 61.5 per cent. An estimated 57.2 per cent of the total employed was engaged in agricultural activities, the highest proportion in the world.

There were an estimated 38 million unemployed persons in Africa in 2006. These are people who did no work at all in a "survey" week, either for pay or assisting in a family business to produce earnings or profits for that business and, most importantly, were actively seeking work. The estimated unemployment rate was 10.3 per cent.

Since 2000, the highest measured unemployment rates (for the most current year available) were in Namibia (31% in 2001), South Africa (27% in 2004), Ethiopia (23% in 2004), Algeria (20% in 2004), and Botswana (nearly 19% in 2001). Very low unemployment rates were found in Madagascar, Tanzania, and Uganda.

In 2003, the average rate of unemployment was 10.9 per cent in sub-Saharan Africa and 10.4 per cent in North Africa (ILO 2004a). These rates are high compared with other developing regions. Sub-Saharan Africa and North Africa have the second and third highest unemployment rates after the Middle East. Regional trends in Figure 6.1 show that African unemployment has not improved over the last 10 years—in fact, unlike most regions, the rate has remained stable around 10 per cent. In 1999, unemployment in South America was slightly higher than it was in sub-Saharan Africa, but it has since declined. Unemployment has also declined slightly in the Middle East and North Africa, but it is still higher than in sub-Saharan Africa.

Figure 6.1: Unemployment rates (%) by region, 1995–2004



Source: Tarantino 2004.

Although high compared with other regions, Africa's unemployment rate seems unrealistically low for several reasons. First, the collection of employment data in Africa is fraught with difficulty. Many countries do not report information; reporting countries give incomplete data; and not all the reported information is comparable across countries.

Comparability problems of employment data in Africa

Labour market indicators may not be comparable across economies for several reasons:

- **Conceptual variation.** National statistical offices, even when using International Labour Organization conceptual guidelines, do not measure employment and unemployment the same way. For example, countries adopt different age limits in their definition of the labour force. Lower age limits in available data vary from age 7 in Uganda to age 18 in Tunisia. Some countries use upper age limits in estimating unemployment rates: age 64 in Egypt and age 69 in Namibia. Moreover, countries such as Lesotho, Zambia and Zimbabwe estimate unemployment rates using the civilian labour force rather than the total.
- **Different sources.** National labour market estimates are based on information from different sources. These differences generate substantial discrepancies in unemployment rates. In South Africa, the unemployment rate derived from employment office records was 5.4 per cent in 1997, while the rate from the 1999 household survey was as high as 25.3 per cent. Unemployment rates in Algeria, Burundi, Mauritius and Nigeria are obtained from official estimates, making them not comparable with unemployment rates in Egypt, Kenya, Uganda and Zimbabwe, which are derived from household surveys.
- **Changing number of observations per year.** Due to seasonality, statistics for a given year may differ depending on the frequency: monthly, quarterly, semi-annually or annually. In some countries, estimates are based on two observations a year: March and September for Mauritius and May and November for Egypt.

Source: ILO 2005.

Moreover, the reported rate does not take into account the large number of discouraged workers. Searching for a job is costly; therefore, one engages in job search only when he/she believes there is a relatively high probability of finding one. In many African countries, the demand for jobs is so high relative to supply that many job seekers consider it a waste of time to look for a job. This is particularly the case in rural areas where the supply of jobs is much lower than in urban centres. In cities, the problem of discouraged workers is thought to affect educated people because they have high expectations of formal high paying jobs. These discouraged workers are not counted as unemployed.

Another reason why the measure of unemployment in Africa is misleading is the high number of working poor. The computation of unemployment rates considers all informal sector workers as employed, although most are either seasonally employed or earn wages below the poverty line; the average unemployment rate does not convey this reality. In 1997, some 56 per cent of total employment earned less than \$1 a day, and 89 per cent earned less than \$2 a day (ILO 2004c). These regional averages mask significant differences among African countries. In 1997, for example, the rate of working poor was about 75 per cent in Mali, while only 3 per cent of workers in Algeria lived on less than \$1 a day.

Africa's employment challenge has six main dimensions:

- Despite appreciable improvement in the level of economic growth on the continent in recent years, aggregate employment growth has been slow relative to population growth. Consequently, the ratio of employed to the adult population in sub-Saharan Africa declined from 69 per cent to 67 per cent in 2005, while the (official) rate of unemployment persisted at around 10 per cent (ILO 2006).
- The number of the working poor is increasing as a result of the declining number of well paid jobs and continuing exclusion of a sizeable proportion of the labour force from the benefits of economic growth. Based on the US\$1 per day poverty line, there were over 148 million working poor in sub-Saharan Africa in 2005, representing 56.3 per cent of total employment (ILO 2006). Many of the working poor are located in the informal sector.
- The level of underemployment in rural and agricultural economies remains high because of the continuing neglect of the rural and agricultural sectors, where most people are employed in low-productivity activities due to low investments, limited access to and linkage with urban markets, dependence on the weather, and limited use of appropriate technology (ECA 2005).
- The exclusion of women from high paying job opportunities persists, with significant costs to overall socio-economic development. In 2004, the female labour force participation rate (for ages 15+) was 62.7 per cent, compared to the male labour force participation rate of 85.9 per cent in sub-Saharan Africa (ILO 2005). Less than 10 per cent of women are in formal employment compared with more than 20 per cent for men, leaving a larger majority of women to take up work in unpaid rural or low-paying urban informal jobs.

- The high incidence and duration of unemployment among young people, especially the increasing unemployment of graduates, undermines investment in education and constitutes a major source of social concern. The youth unemployment rate in sub-Saharan Africa stands at an average of 21 per cent, driven by generalized lack of employment; high population growth rates; low literacy rates; poor quality education; and skills mismatch (ECA 2002).
- The dearth of employment statistics imposes severe constraints to policy making. Africa is the most under-reported region in the world with regard to employment records. Identifying areas of high employment, monitoring employment performance and formulating employment policies to generate better employment outcomes requires reliable, up-to-date and consistent statistics. Many national statistical offices lack the human and financial capacity to collect and disseminate employment data. This is compounded by the growing “informalization” of the economy, necessitating more innovative fiscal and technical approaches to the production of employment statistics.

In September 2005, as part of the monitoring process, the AU Commission and the regional economic communities (RECs), with the support of the ILO and other UN agencies, convened a meeting to review progress made towards the implementation of the Lagos Plan of Action. Key observations presented include the following:

- Member states are implementing various aspects of the Plan of Action without, for the most part, adopting a comprehensive approach. Without coherent national frameworks for employment generation, employment issues are not adequately embedded in national development programmes.
- Sub-regional and national coordination of implementation and monitoring is weak as a consequence of inadequate human and institutional capacity.
- There is need for further elaboration of implementation strategies at all levels—national and regional.

As a result of these conclusions, the AU/RECs meeting recommended technical assistance from ILO, ECA and other partners to develop the capacity of national and sub-regional institutions in employment policy formulation and monitoring, including statistical data collection and employment evaluations.

The Ouagadougou plan of action proposed a set of 11 key priority areas (Table 6.2).

Table 6.2: Condensed matrix of the Ouagadougou Plan of Action

Area	Priorities		
Policy Environment	Political leadership and commitment to create an enabling environment of good governance	Creation of an environment for resource mobilization	Development of framework for integration and harmonization of economic and social policies
Sector Approaches	Promotion of agriculture and rural development	Utilization of sectors with high employment potential	
Institution/ Partnership	Building human and institutional capacity of employment creation agencies	Building international cooperation and partnerships for the employment agenda	Strengthening cooperation among RECs
Social Protection and Vulnerability	Development of social protection schemes for workers and their families	Empowerment of women in the labour market and in development	Empowerment of vulnerable groups

Source: African Union 2004

The critical implementation challenges underlying the Ouagadougou Plan of Action are as follows:

- Developing the framework for placing employment at the centre of poverty reduction strategies and other national development programmes, as well as in the NEPAD priorities, and bilateral and multilateral development cooperation programmes;
- Designing programmes for economic diversification, especially for agricultural and rural economies, that are economically and environmentally sustainable and the methodology for identifying and investing in activities with high employment content;
- Developing labour legislation that is sufficiently attractive to investors and also enhances employment, especially for women and young workers;

- Implementing policies and resolutions towards regional integration;
- Designing human resource programmes that focus on skill development, and in particular provide the means to harness the creativity of the human population, especially that of women and young people; and
- Identifying and building capacity in policy formulation and monitoring.

Generally, trade unions have not been key players in employment creation. However, there are many ways where trade union action can have direct implications on the enhancement of employment opportunities and elimination of poverty.

1. Self development

It is the pervasive view that skills development of workers is entirely the domain of employers. The reality, however, is that many employers spend very little resources on training, and when they do, it is mostly the management staff who benefit from such opportunities. Many workers at the shop-level rarely get the chance to further enhance the skills and training.

Trade unions should encourage and motivate their members on the importance of training and skills acquisition in line with existing market demands and counteract the implications of cutting-edge competitive tendencies brought about by globalization.

2. Financial empowerment of trade unions

For trade unions to play a more meaningful role in job creation and poverty alleviation, they should aim at becoming major economic actors themselves. For instance, trade unions in South Africa and Ghana are devising financial strategies to supplement their collective bargaining strengths. The launching of the Labour Enterprise Trust by the Ghana Trades Union Congress is expected to raise about US\$ 20 billion aimed at investing the funds to create more sustainable employment opportunities in firms threatened by privatization and foreign competition. In a similar vein, the Community Growth Fund in South Africa has so far attracted over US\$ 30 million.

3. Trade unions to collaborate with multi-lateral and bi-lateral donor organizations

It is now imperative for trade unions to collaborate with donor organizations to design and implement self-employment programmes for the unemployed, especially the retrenched workers returning to rural areas and to the informal sector.

4. Importance of organizing to strengthen trade unions

The strength and credibility of a trade union is founded on its ability to recruit and retain a significant proportion of the workforce and, through representation, obtain good remuneration and conditions from employers and a strong framework of social protection from governments. Every trade union has, therefore, to constantly keep its organizing strategies up-to-date to meet the changing needs and aspirations of workers. Trade unions need to strengthen their efforts to particularly recruit women workers and the youth.

(c) Globalization and global governance



<http://www.gadonet.com>, 4 December 2003

Globalization does not necessarily lead to prosperity for all and is not a guarantee for growth and employment for all. Globalization embodies many threats and challenges but it also has numerous opportunities that can be tapped. Given that globalization is an irreversible process, Africa has to adapt to this process and seize the potential opportunities that exist for the economic and social progress of the continent and its integration in the global economy.

ILO declaration on “social justice for a fair globalization” adopted in June 2008

The Declaration speaks of the need to make a different reality possible. In place of our world of income inequality, high levels of unemployment and poverty and the growth of unprotected work, the adoption of this Declaration demonstrates a common commitment to build a world based on social justice. The Declaration provides for regular review by the ILO of the components of decent work, which are now codified as inseparable and inter-related. It comprises, in particular, many paragraphs confirming the mandate for the ILO—deriving from its Constitution—to examine all economic, financial and trade policies, since they all affect employment. It is clearly the ILO’s role to evaluate those employment effects in order to place employment and decent work at the heart of economic policies. Achieving this will require the ILO to make a strong and effective impact on the activities and policies proposed by the International Monetary Fund, World Bank and the World Trade Organization.

A globalized world economy requires effective global governance. There is need to increase inter-governmental cooperation to ensure that the social dimension of globalization, including decent work and fundamental workers’ rights, is at the centre of decision-making at world’s major global and regional institutions. These include the World Bank, International Monetary Fund, World Trade Organization, United Nations and its specialized agencies, especially the International Labour Organization (ILO) with its tripartite structure and mandate to set international social standards.

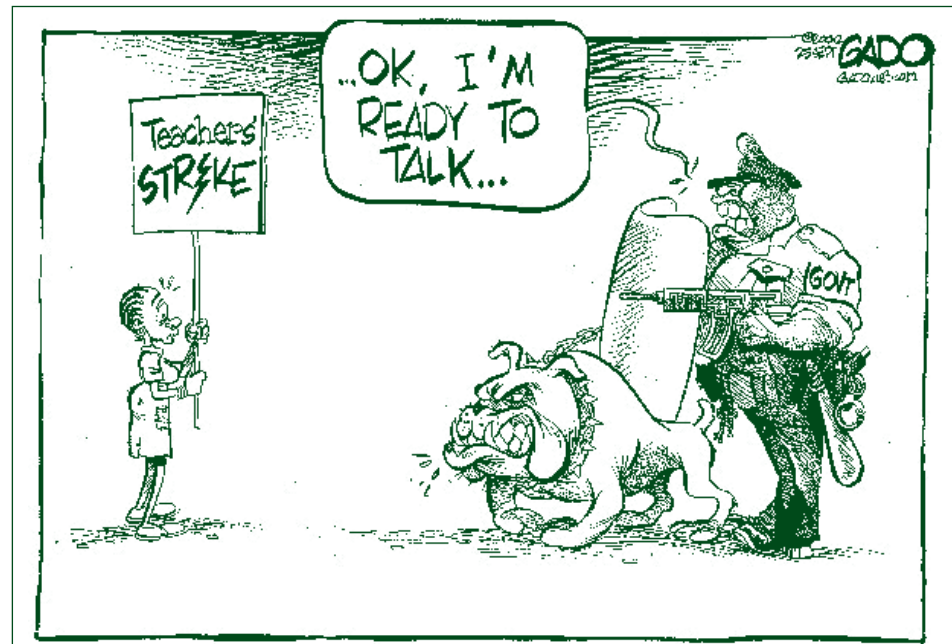
The international trade union movement should also work with its global unions partners to promote effective rules governing the behaviour of private business. They should seek to achieve international frameworks for social dialogue and collective bargaining, and systems of corporate governance that hold management accountable for the social impact of business activities. This requires a combination of campaigning and mobilization with advocacy and lobbying so that the policies of these institutions and companies support, rather than undermine, the achievement of decent work for all. This includes action around:

- Trade, investment and labour standards;
- Health and safety at work and sustainable environmental practices;
- Global governance;
- Social responsibilities of business, including global social dialogue;
- Social protection and sound legal employment relationships;
- Trade union organizing;
- Fighting HIV and AIDS; and
- Combating child labour and forced labour.

(d) Trade union organizing and economic development in Africa

“Our deepest fear is not that we are inadequate. Our deepest fear is that we are powerful beyond our measure. It is our light, not our darkness, that most frightens us.”

Nelson Mandela (born 1918), South African statesman and the first democratically elected President of South Africa (1994), and winner of the 1993 Nobel Prize for Peace



Daily Nation, 25 September 2002. <http://www.gadonet.com>

The historical development of the African trade union movement is closely linked to the political, social and economic development of the continent. In many countries, the trade union movement was brought together prior to or immediately after political independence. From then on, trade union activities and membership flourished due to the favourable legislation, economic growth and political patronage.

Trade union membership grew steadily before taking a downward trend with the emergence of the economic shocks of the 1980s. This is mainly attributed to stringent economic reform measures and public sector reforms that resulted in massive retrenchments and redundancies. The decline in membership was further aggravated by the enactment of new “investor friendly” statutes that were aimed at deregulating the labour market. The labour market scenario became hostile to trade unions, thus making it difficult for the unions to organize freely. The backlash of past union friendly labour laws exposed the vulnerability of unions, especially in areas of organizing and recruitment. Current investor practices such as hiring on contract basis and casualization of labour have impacted negatively on trade union membership. Other factors such as the HIV/AIDS pandemic, retirements, natural wastage and the growth of the informal economy have also affected union membership.

Consequently, the decline in trade union membership has affected trade union finances and operations. Internal strife leading to splits in unions have led to union fragmentation and further weakened the trade unions. In this current state, unions are vulnerable to external machinations and influence. Weak institutional frameworks and physical infrastructure present further constraints for most unions. Unions are also known to lack capacity in terms of human resources, including professional acumen.

In the context of declining density and power, African unions have engaged in a debate about their survival. The principle priority for unions in Africa is that every worker in Africa needs a union. The starting point for unions must remain what trade unionists know everywhere: build union strength from the grassroots; broaden union range of services to members; and modernize structures and the administration of scarce resources.

Economic factors influencing trade union organizing in Africa

Globalization: Liberalization of international trade, coupled with the globalization of financial markets and the increasing prominence of multinational companies is today threatening the national context within which trade unions operated.

Regional integration: Cross-national comparisons of labour costs affect national competitiveness and also shape corporate investment decisions and these constrain the conduct of national collective bargaining. The stability of national currencies seems to require that governments adopt deflationary economic policies often against the interests of labour.

Changes in labour relations: The role of trade unions and their focus is becoming narrow due to restructuring of commercial and industrial entities at a global level. Their collective bargaining positions are getting weaker, though not yet extinct.

Low economic growth: Many economies in Africa are characterized by low economic growth and high unemployment. This has posed serious problems for the trade unions as many workers are reluctant to join unions as new entrants or to remain members.

High unemployment: Reluctance on the part of workers to join unions or remain members is based on their fear of job loss in an environment that is hostile to trade unionism and any form of resistance to working conditions. Today, most trade union leaders' ability to negotiate has been reduced due to reduced economic strength, which has affected their political influence.

Changing composition of the workforce: The traditional strongholds of unions among manual workers in large establishments in traditional sectors such as coal mining, metal-working, textiles, docks, railways, and the public sector have seen rapid decline in the number of employees due to the worldwide trend of privatization. At the same time, the areas of growing employment have often been in the private service sector and in smaller workplaces, where unions have usually found it far harder to recruit and represent members.

Changes in the type of workforce: Trade unions have mainly represented full-time employees with relatively secure jobs, and they have often seemed to assume that the 'typical' worker would be male. However, in many countries, the labour force has become more evenly balanced between men and women; part-time employment has become more common; temporary contracts have become widespread; and in addition, there has

been an increase in migrant labour in many countries. In some cases, such changes have been linked to the growth of an 'informal economy' and a 'submerged' labour force.

These changing patterns of employment pose problems for trade unions. On the one hand, the workers with new and scarce qualifications are often confident that they can survive in the labour market, and advance their personal career without any need for collective support in unions. Unionization is even more difficult if—as is often the case—they work for small firms or are self-employed. On the other hand, the marginal workers are difficult to organize because they are often scattered; are sometimes illegally employed; may work fluctuating hours; and are vulnerable to victimization and dismissal if they do join a union. They may also view trade unions as organizations that are not particularly interested in such workers.

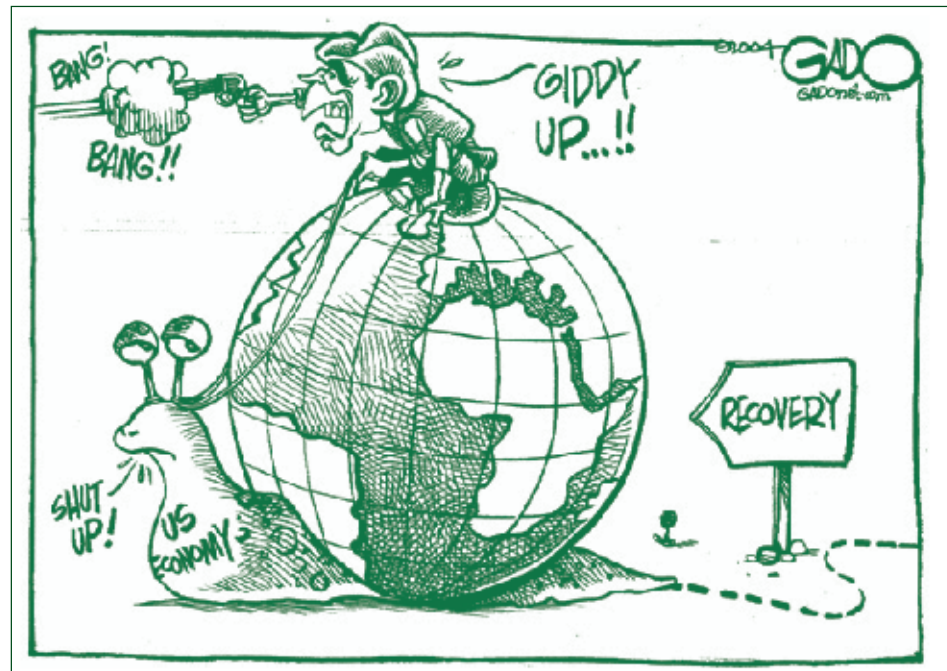
Reduced protection through legal and institutional framework: This entails the replacement of a legislative regime that favours negotiated relationships with one that favours the interest of the employer. Some of the affected legislation includes the reduction of the statutory immunities of trade unions and collective bargaining, increasing the legal rights of members against their unions, attacking the legislative basis of trade union organizations and collective bargaining, and reduction of rights of individual employees.

Industrial relations policies pursued by management: In many countries in Africa, there exists a tripartite industrial relations system, which aims at inducing social economic development while helping maintaining political stability. However, due to the changing policies and legislation, companies have redefined the industrial relations practices to their favour. This includes employing direct contract systems with employees, declaring workers to be in management; categorizing them as essential workers; or using individual pay agreements and intimidating workers who venture into trade union activities.



<http://www.gadonet.com>

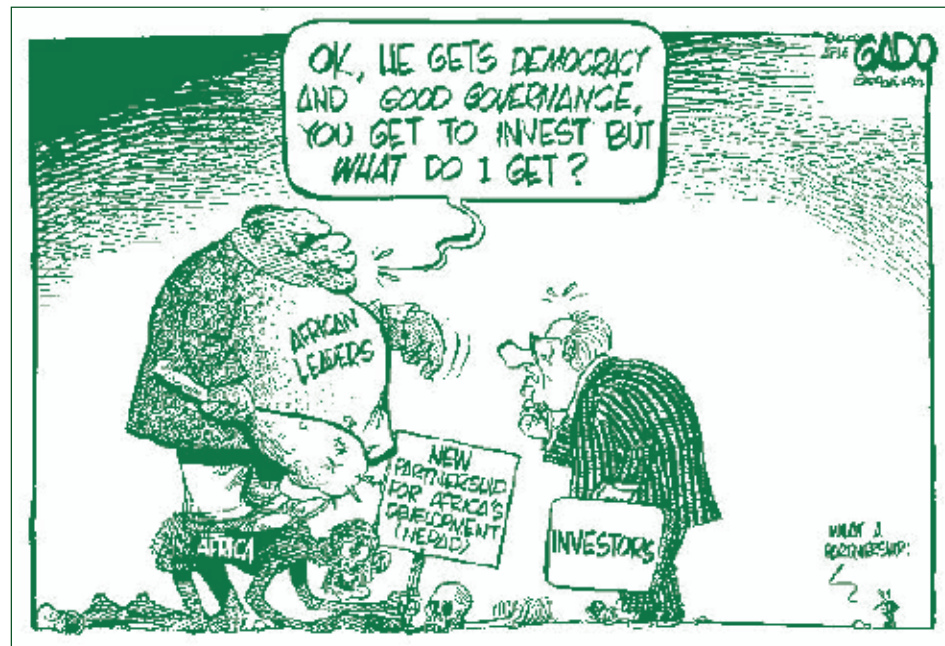
(e) Build capacity for effective participation in economic programmes



Daily Nation, 27 January 2004. <http://www.gadonet.com>

Many civil society organizations and unions have expressed concern that governments and their international partners rarely involve the communities in economic programmes. There are few instances where civil society participation took place but where organized labour was not invited at all. In many other consultation processes where trade unions were invited, this did not happen in a meaningful way. Engagements have often been cosmetic and hastily done.

Community organizations and trade unions have a specific and important role to play in order to ensure that the new poverty reduction commitments translate into effective change on a country level. The maintenance of peace and security within and among nations; democracy, the rule of law, the promotion and protection of all human rights and fundamental freedoms, including the rights to development; effective, transparent and accountable governance; gender equality; full respect for fundamental principles and rights at work and the rights of migrant workers are some of the essential elements for the realization of social and people-centred development.

(f) Making NEPAD work for African people

Daily Nation, 16 April 2002. <http://www.gadonet.com>

Analysts have observed that while NEPAD's stated goals may be well intentioned, the development vision and economic measures that it canvases for the realization of these goals are largely flawed. As a result, NEPAD may not contribute to addressing the developmental problems, and may actually inadvertently reinforce the hostile external environment and the internal weaknesses that constitute the major obstacles to Africa's development.

Some of the critical flaws of NEPAD include:

- the neo-liberal economic policy framework, which seems to be implicitly embedded at the heart of the plan, thus repeating the structural adjustment policy packages of the 1980s and 1990s.
- limited role played by the African people in the conception, design and formulation of the NEPAD, in spite of its proclaimed recognition of the central role of the African people.
- its main targets are foreign donors, particularly in the G8, European Union, the Nordic countries, the United States, and the World Bank—the NEPAD sounds like a “partnership” between its secretariat and the developed world.
- it under-emphasizes the external conditions fundamental to Africa's developmental crisis, and thereby does not promote any meaningful measure to manage and restrict the effects of this environment on Africa development efforts.
- NEPAD is essentially a-historical and does not address the unequal relations of the last four decades, thus constituting an inadequate response to the continent's under-development.

“...There are key cross-sectoral areas that require further analysis and policy development. These include the promotion of decent work in the rural economy (to which the 2008 International Labour Conference discussion will contribute); labour market governance, where the ILO must support its constituents’ efforts to balance flexibility and security, combining legislation, institutions, dialogue and economic policies; and the ways to embed the ILO’s goals and values in growing global production networks, combining productivity, competitiveness and decent work.”

*Juan Somavia,
Director-
General,
International
Labour
Organization
Programme and
Budget for 2008-
09, March 2007*

- While recognizing the central role of agriculture, the bias towards a certain model of agriculture–commercial and export orientated–points to gaps in its conception of a more wider and deeper perspective on rural development.
- It is now over three years since the launch in Abuja, but there has been very little concrete progress, although plenty of meetings, summits, pronouncements, rhetoric, and speeches have marked the NEPAD thus far.
- NEPAD does not integrate respect for core labour standards and there is no formal structure to address trade, development, employment and core labour standards. It is vital to have the inclusion of social, labour, gender, environment, and development concerns in NEPAD’s trade and development policy review mechanisms.

(g) Promoting the rural economy in Africa

It is estimated that about 70 per cent of the African people live in rural areas in sub-Saharan Africa. Although rural areas in Africa are full of diversity and vitality, the more acceptable global image is that of partial, superficial and somewhat discriminatory vision. The dominant iconography of rural Africa is flooded with portrayals of malnourished children, displaced populations, communities falling apart and helpless people. These images have spread a perception of rural Africa as a cosmos in decline, composed of people that seem to be out of history and have no hope and destiny. Such prevailing images serve their purpose well: to inspire emotions and reflexive sympathy. But they do little to show the real lives, strives and accomplishments of the vast majority of the rural population. All these issues notwithstanding, there is a different imagination of the African rural economy: that, despite their enormous constraints, rural areas in Africa are indeed organized and engaged with vigour to improve their situation and adapt themselves to a rapidly evolving future.

Why focus on the rural economy?

Six major factors underline the recent focus on the rural poor:

- About 70 per cent of Africans live in rural areas
- Overwhelming numbers of the rural poor are vulnerable to external shocks, natural disasters, conflicts, and the spread of diseases including HIV/AIDS
- Poverty is growing in Africa compared to other regions
- Poverty in rural areas is not only widespread but it is also deep and severe
- New initiatives bring the rural poor to the centre of development dialogue
- Few countries will be able to meet the agreed Millennium Development Goals, particularly in the rural areas

The focus on rural poverty is also important because the international community's commitment to cutting the global incidence of absolute poverty in half by 2015 implies a massive effort in rural Africa. In addition, an understanding of the extent, nature and causes of rural poverty is a precondition for effective public action to reduce deprivation in rural areas of the continent.

Poverty in many African countries is predominantly a rural phenomenon. The rural population represents an average of 60 per cent of the total population on the continent; about 90 per cent of the rural labour force engages directly or indirectly in agricultural activities. Agricultural development and rural development are crucial for the structural transformation and development of Africa. Agriculture contributes 20 per cent of GDP in North Africa and 30 per cent of GDP in sub-Saharan Africa.

Rural poverty in Africa is embedded in an overall poverty context at the national level. Rural poverty in sub-Saharan Africa contributes more than 60 per cent of the incidence of total poverty as measured by the head-count ratio. The contribution of rural poverty is in excess of 90 per cent of total poverty in Burkina Faso, Mali, Niger and Uganda, and in excess of 80 per cent of total poverty in Ethiopia, Gambia, Kenya, Madagascar, and Swaziland.

Rural people are not only income-poor, but they are also deprived from the substantive "capabilities" necessary to lead a decent and meaningful life. Deprivation of elementary capabilities can be reflected in, among other things, premature mortality, under-nourishment, morbidity and illiteracy. For primary education indicators, the picture is such that not only is rural deprivation on account of this indicator higher but also the differences between countries are large. Detailed information shows relatively high net primary school enrolment ratios in the rural sector for Kenya, Ghana, Zambia and Nigeria, with an enrolment ratio of between 50 and 75 per cent. The most deprived rural sectors are to be found in Ethiopia, Niger, Mali, and Senegal with a ratio of between 13 and 22 per cent. For the secondary school enrolment ratio, the level of deprivation of the rural sector is much deeper compared to the primary school indicator.

The deprivation of rural sectors is not only apparent in education but also in access to basic health-related services such as sanitation and piped water. The overall national averages are 51.4 per cent for access to sanitation and 29.1 per cent for access to piped water. Within the context of this overall deprivation, the rural sector is much more deprived than the urban sector. Access to sanitation in the rural sector averaged 41 per cent compared to about 81 per cent for the urban sector.

Countries with relatively high rural access to sanitation include Tanzania, Kenya and Uganda with an access rate of between 56 and 92 per cent. At the other end, the most deprived rural populations on account of this indicator are found in Ethiopia, Nigeria, Burkina Faso, Niger, and Ghana with access of between 5 and 17 per cent.

Similar differential deprivation between the rural and urban sectors is observed for the indicator of access to piped water. Thus, compared with the urban sector, which is also poor and deprived, the rural sector is poorer and more deprived in terms of capabilities.

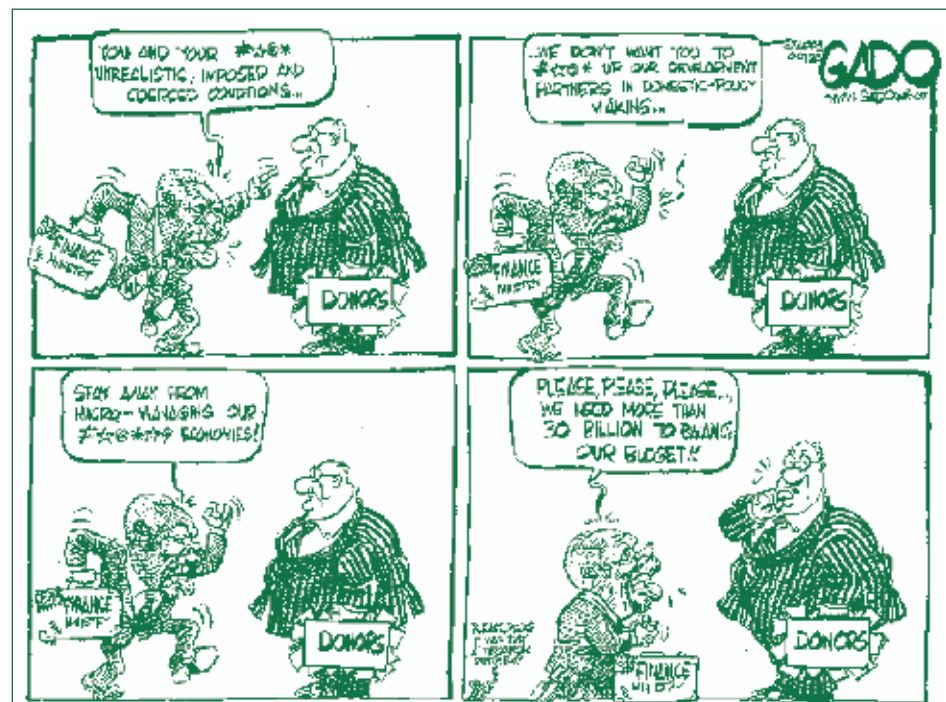
The state of rural poverty in sub-Saharan Africa is not only widespread, but it is also deep and severe, varying among countries. For example, for three poverty measures (headcount ratio, poverty-gap ratio, and squared poverty-gap ratio), Ghana emerged as a low rural poverty country where the spread of poverty is 34 per cent, while its depth and severity are 8 and 2.4 per cent, respectively. At the other extreme, Zambia is a high rural poverty country with about 81 per cent of its rural population living below a poverty line of about US\$ 25 per person per month.

In terms of depth of poverty, Central African Republic (CAR) is clearly a high rural poverty country with a poverty-gap ratio of 46.4 per cent while, in terms of severity, Guinea Bissau is the country with the highest squared poverty-gap ratio of about 35 per cent. To further appreciate the extent of the depth of rural poverty, it is to be noted that the mean expenditure of the rural poor in Guinea Bissau, Ethiopia and CAR is only about 32 US cents per person per day. For Ghana, at the other extreme, the mean expenditure of the rural poor is 81 cents per person per day. These are indeed dramatic figures reflecting the depth of poverty in rural Africa.

In the majority of sub-Saharan countries, the contribution of rural poverty to the depth of poverty at the national level is in excess of 70 per cent. Rural poverty contributes more than 90 per cent of the depth of poverty at the national level in Burkina Faso, Madagascar, Uganda, Mali, and Niger. Similar observations can be made about the contribution of rural poverty to the severity of poverty at the national level.

Poor, unskilled, and uneducated people in rural areas are also most vulnerable and suffer disproportionately from multiple risks, shocks and volatility, and they have few instruments for mitigating these adverse events. Poor rural Africans have become vulnerable to risks emanating from globalization and external shocks, conflicts, HIV/AIDS and natural disasters.

African leaders have in various fora—such as the Summit in Libreville in 2000 and the OAU Summit in 2001—reaffirmed that this is indeed their primary goal. The leaders of the industrial countries have also pledged to assist developing countries in this critical endeavour. This commitment was re-affirmed last year by the adoption of the UN Millennium Development Goals (MDGs) by virtually all countries. Multilateral financial institutions and other donors have stressed the importance of refocusing on the rural poor. The important initiatives that have emerged from the consensus on the need to reduce poverty include debt relief initiatives, the New Economic Partnership for Africa's Development (NEPAD), and the New Vision of the African Development Bank Group.

(h) Reconstitution of the developmental state

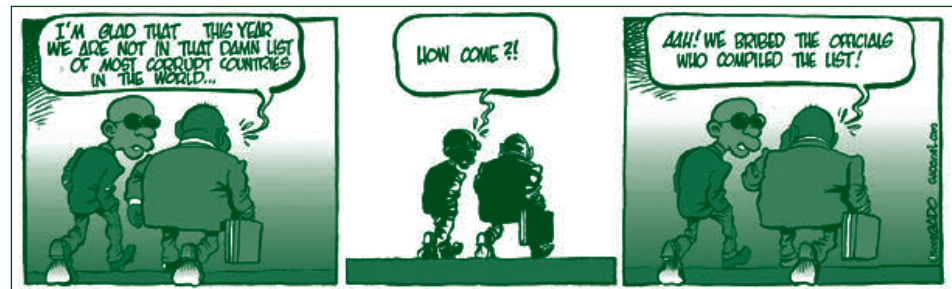
Daily Nation, 28 October 2001. <http://www.gadonet.com>

For Africa to attain higher levels of progress, there is need for the reconstitution of the developmental state; a state for which social equity, social inclusion, national unity and respect for human rights form the basis of economic policy; a state which actively promotes and nurtures the productive sectors of the economy; actively engages appropriately in the equitable and balanced allocation and distribution of resources among sectors and people; and most importantly a state that is democratic and which integrates people's control over decision making at all levels in the management, equitable use and distribution of social resources.

Furthermore, to achieve sustainable, broad-based economic growth, there is need for more open, accountable and participatory political systems, including a stronger role for civil society. Political, economic and social reforms must be initiated and carried out by African countries themselves, based on their visions, values and individual socio-economic background. Africa's development partners should, therefore, support African initiatives in these areas.

African governments must reaffirm their commitment to improving the quality of governance, in particular transparency and accountability in public administration. Governments must recognize that criteria for public expenditure should aim at enhancing overall socio-economic development and reducing non-productive expenditures. The building of human and institutional capacities for sustainable development is essential for all of these objectives.

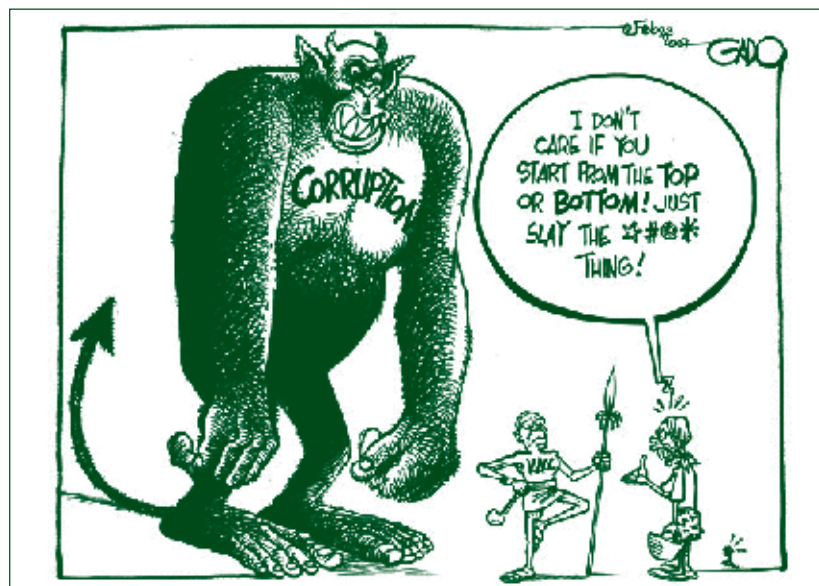
(i) Encourage sound macroeconomic fundamentals



<http://www.gadonet.com>, 10 February 2003

The labour movement seeks to encourage that national development plans must promote agriculture, industry, services—including health and public education. Similarly, plans must be protected and supported through appropriate trade, investment and macroeconomic policy measures. A strategy for financing must seek to mobilize and build on internal and intra-African resources through imaginative savings measures; reallocation of expenditure away from wasteful items, including excessive military expenditure, corruption and mismanagement; creative use of remittances of Africans living abroad; corporate taxation; retention and re-investment of foreign profits; and the prevention of capital flight, and the leakage of resources through tax evasion practised by foreign investors and local elite. Foreign investment, while necessary, must be carefully balanced and selected to suit national objectives.

(j) Economic development through sensible privatization



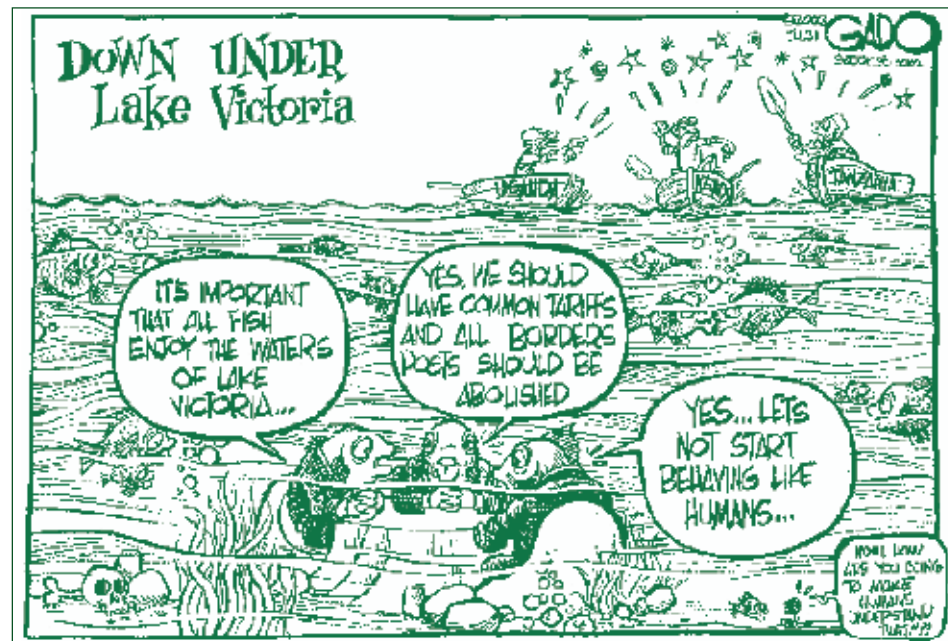
Daily Nation, 23 February 2007, <http://www.gadonet.com>

It is not disputable that the private sector is vital as an engine for sustainable development. As such, the labour movement in Africa is particularly interested in the social aspects of privatization, structural adjustment and economic transformation. However, trade unions are also concerned that Africa is strewn with disastrous effects of privatization affecting the economic, political and cultural fabric. Experiences of hardship faced by

workers and their families have indicated that privatization and economic transformation of countries have been undertaken without due concern to the stakeholders.

The term “privatization” is now in such common use that it has become a household reference involving the transfer of rights of ownership or service-provision from the public sector to the private sector. However, since privatization forms an important component in the larger economic reform programme, it received cold reception from workers, among others. Regrettably, this has been due to the fact that social dialogue in the privatization and restructuring process is often neglected, and hence the lack of appreciation and enthusiasm by trade unions in the process. For changes to mean progress, and reforms to be economically, socially and politically acceptable, a transparent form of consultations with stakeholders is of paramount importance.

(k) Regional integration



Daily Nation, 21 July 2003. <http://www.gadonet.com>

Many countries in Africa are taking greater interest in regional economic integration and have developed programmes for the promotion of this cause. Trade unions, for their part, have also explicitly supported the emergence and strengthening of regional integration. The labour movement is on record as having called for increased government efforts to bring about faster regional economic integration. Trade unions have been reliable partners in various activities of such economic and social interest groups.

Of concern to the trade union organizations is the fact that the resulting regional integration agreements have mainly concentrated on capital and natural resource mobilization and have tended to ignore the critical role of human resource mobilization and other social aspects. Trade unions have reiterated that for integration to be successful, the stakeholders, of whom

workers and their organizations are a major component, must be involved in the design process, decision making machineries and implementation of all programmes and project activities. Social aspects such as poverty eradication, human and trade union rights, the creation of decent jobs and the observance of international labour standards should always be among the main priorities.

The trade union position is that present efforts to foster economic co operation and regional integration are doomed to fail if they continue to focus on the narrow areas of international trade and customs union.

(I) Conflict resolution and peace for development



Daily Nation, 3 June 2003. <http://www.gadonet.com>

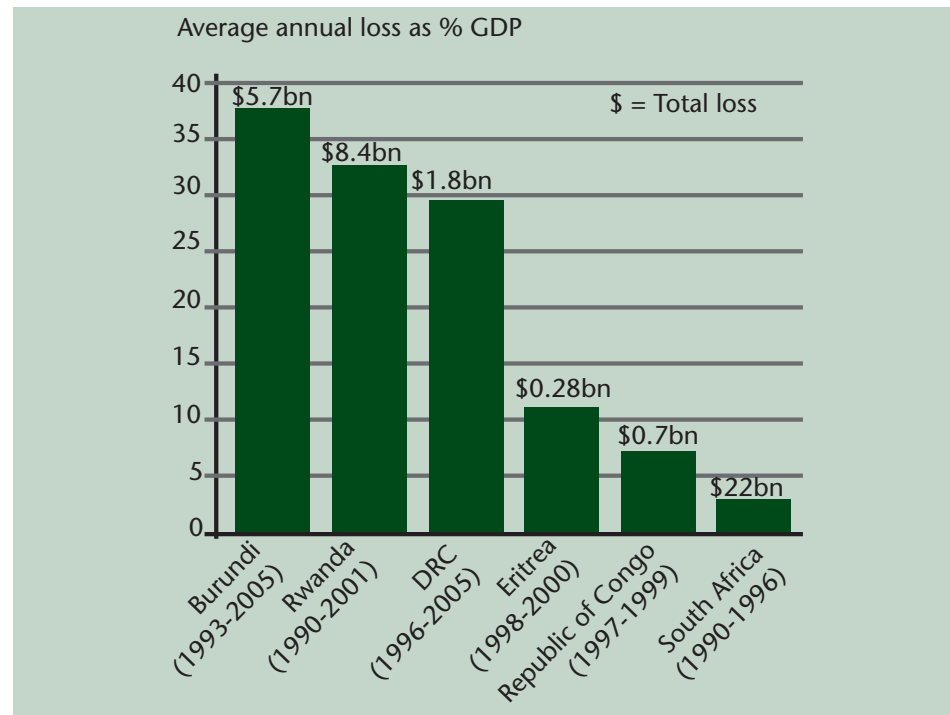
A study by Oxfam International found that fifteen years of conflicts cost Africa about \$300 billion between 1990 and 2005. This is equal to the amount of international aid received during the same period. The continent loses an average of around \$18 billion a year because of armed conflict. Africa has the disadvantage of being a continent at war with itself. Most conflict situations have been blamed on colonial legacies as well as the unequal distribution of resources among the many ethnic communities. Ethnic and religious differences are also responsible for the continent's conflicts.

Continued conflicts and political uncertainties in Africa add to difficulties of the region as a whole, limiting groundwork for stronger growth. While the trend for many African countries is one of slow economic improvement, those nations in conflict suffered negative growth and an alarming deterioration in basic conditions.

The report notes that between 1990 and 2005, 23 African nations were involved in conflict and, on average, this cost African economies US\$ 18 billion a year. It concludes that African governments have taken encouraging steps at a regional level to control arms transfers, but that

what is needed is a global, legally-binding arms trade treaty. Those born in African countries beset by conflict are also likely to have shorter life expectancy, and infant mortality rates are higher than in other more stable countries. Sierra Leone is a striking illustration of this trend, having the region's lowest life expectancy rate of just 37 years.

Figure 6.2: Cost of conflict: Average annual loss as % of GDP for selected countries

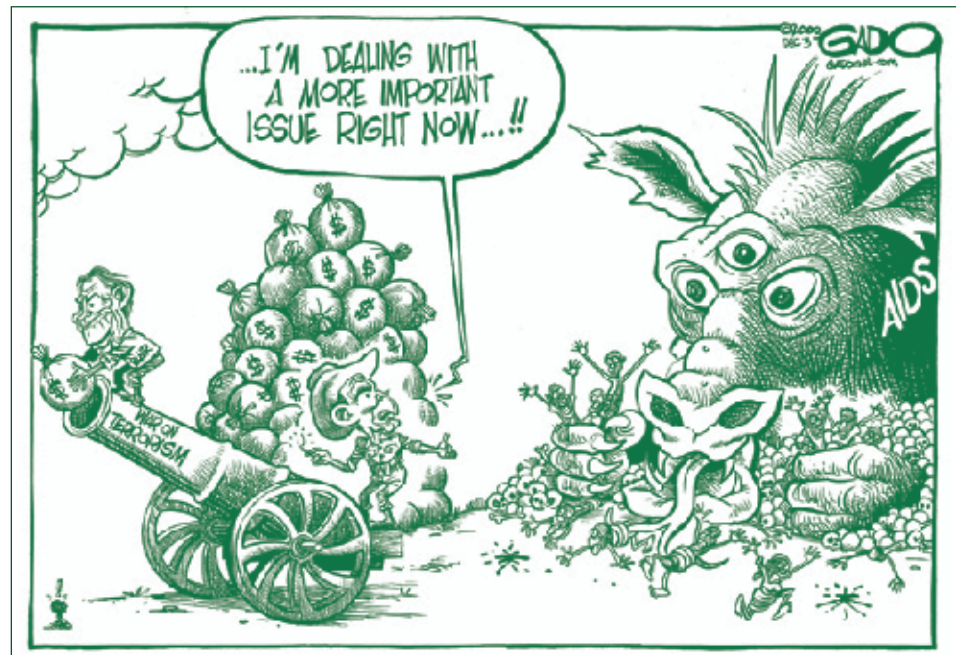


Source: Oxfam 2008.

By fighting for social justice and decent work against inequalities and violation of human rights, trade unions can contribute to the eradication of the causes of conflicts. Their ability to organize effectively and carry out a structured social dialogue based on negotiation enables them to be reliable and influential partners in dialogue. Furthermore, given that they are deeply rooted in various social groups, they are able to promote dialogue and the emergence of consensus between different population groups. In the Great Lakes region in Africa, trade unions have accomplished much in their efforts to overcome the bitter legacy of genocide and inter-ethnic rivalry.

(m) Devastating effects of the HIV/AIDS pandemic

HIV/AIDS is now considered as the most formidable development challenge of our time. AIDS is now a world-wide problem, but it has hit sub-Saharan Africa the hardest. 70 per cent of all adults and 80 per cent of all children in Africa live with HIV, and 75 per cent of the global deaths due to AIDS since the epidemic began have been African men, women, and children. It is more disconcerting to read recent reports that nearly 90 million Africans (or up to 10% of the continent's population) could be infected by HIV in the next 20 years if more is not done to combat the epidemic.



Daily Nation, 3 December 2006. <http://www.gadonet.com>

What makes HIV/AIDS unique is its impact on development, for it undermines five of the latter's foundations: economic growth, good governance, development of human capital, the investment climate, and labour productivity.

AIDS costs a typical African country more than 0.5 per cent per capita growth every year. Because this disease kills so many young adults in the prime of their lives, the impact on both the public and private sector is devastating.

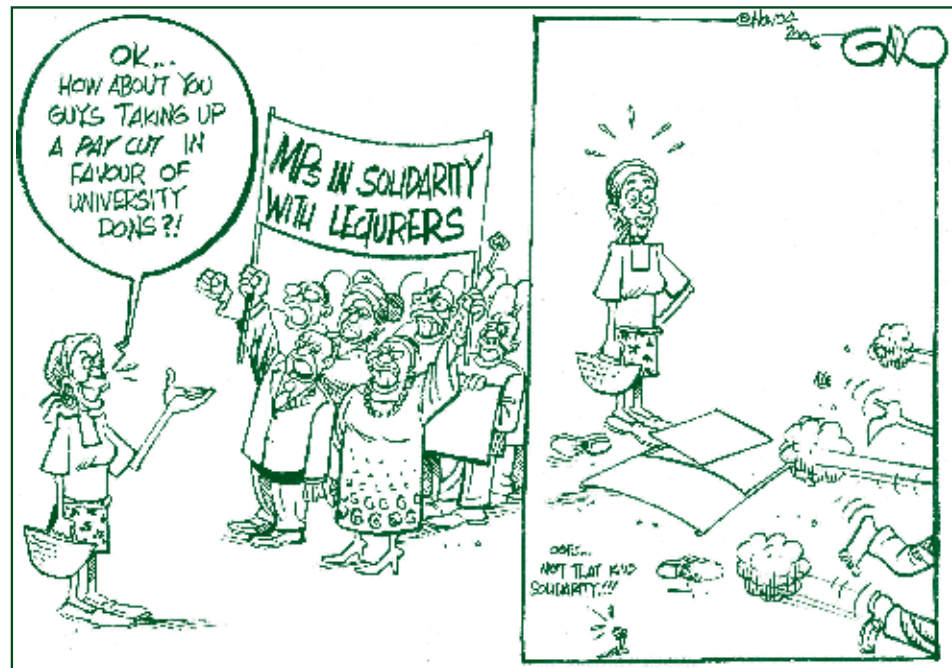
The above alarming statistics show that for those of us who live in sub-Saharan Africa, it is a human catastrophe from which no single one of us in the region will be exempted because HIV/AIDS affects every one. Stigma, silence, denial and discrimination against workers living with HIV/AIDS increases the impact of the epidemic and constitutes a major barrier to effectively penetrating the workplace and getting the desired results after implementing HIV/AIDS activities.

Workers continue to be subjected to a mandatory HIV test at the time of recruitment and promotions. Creating an environment free from discrimination of people living with HIV/AIDS and breaking the wall of silence will ensure a proper response.

There is need to re-emphasize and appreciate the importance of networking and alliance building in order to win the war against HIV and AIDS. Tackling the epidemic effectively should constitute an integral part of our African agenda for promoting sustainable development, poverty reduction, peace and security and political stability consistent with the Millennium Development Goals.

There must be a workable framework that aims to identify and suggest measures to combat HIV/AIDS more effectively at the workplace by developing policies and strategies that will guide the actions of all partners within the trade union movement and the workplace. This framework must also aim at highlighting measures of improved HIV/AIDS policies and strategies so that workers infected and affected with HIV/AIDS and their families will have a new vision for the future.

(n) Promoting labour standards for economic prosperity



Daily Nation, 4 November 2006. <http://www.gadonet.com>

The introduction of structural adjustment policies in the early 1980s brought to the fore the realization that implementation of economic reforms per se could be inconsistent with the provisions on basic international labour standards, particularly certain core human rights conventions, as well as other standards that have special relevance to particular structural adjustment interventions. The labour movement, in particular, has expressed concern that an important element of structural adjustment policies has been to dismantle fundamental forms of labour protection in order to set in motion a development process based on a purely economic rationale.

There must be strong advances of the view that many international labour standards can be of relevance in guiding the process of economic reforms. While these standards may not address all the issues involved in labour market flexibility debates, they certainly help provide a balance between excessive state regulation and an arbitrary removal of guarantees. Empirical evidence abounds indicating that international labour standards have had a far reaching influence because of the content, but also because they have influenced the more general activities of the international community in such fields as human rights, social policy and development policy.

(o) Bridging the digital divide through Information and Communication Technology

Africa must take cognisance of the fact that the Information and Communications Technology (ICT) revolution offers genuine potential, but also raises the risk that a significant portion of the world will lose out. ICT can have a far-reaching impact on the quality of life of workers in poorer countries if the right policies and institutions are in place, and serve as important spurs to development and job growth. Access to the technologies, and ensuring that workers possess the education and skills to use them, are fundamental policies that developing countries need to consider if they are to benefit from the ICT revolution.

In order for African people to benefit from ICT, and for the labour movement to bridge the digital divide, African governments must develop and implement coherent strategies towards ICT.

(p) The informal economy in Africa



Daily Nation, 11 November 2003. <http://www.gadonet.com>

The term “informal economy” refers to all economic activities by workers and economic units that are—in law or in practice—not covered or insufficiently covered by formal arrangements. The term is now widely used even though there is no common definition of what is meant by the same. Controversy still exists among scholars on what constitutes the most appropriate definition. Terms such as ‘unregulated’, ‘unregistered’, ‘residual’, ‘irregular’, ‘appendage to the formal sector’, ‘peripheral’ and self-employed sector have been used to describe the economy.

In spite of lack of a universally accurate or accepted description or definition, there is a broad understanding that the term “informal economy” accommodates considerable diversity in terms of workers, enterprises and entrepreneurs with identifiable characteristics. They

experience specific disadvantages and problems that vary in intensity across national, rural, and urban contexts. The term “informal economy” is preferable to “informal sector” because the workers and enterprises in question do not fall within any one sector of economic activity, but cut across many sectors.

The scope of informal economy activities is wide and includes trading, restaurants, food processing, clothing, metal fabrication and repairs, wood processing, handicrafts, construction, garages, repair services, and transport. These activities exist also in the formal economy.

The ILO discovered the importance and potential of the informal economy through the famous study of the informal sector in Kenya published in 1972. The debate on the role of informal economy on Africa’s economic development has been brought to the fore even much more during the period of implementing economic reforms, the so called Structural Adjustment Programmes (SAPs) during the 1980s and 1990s. To many observers, the stringent macroeconomic measures adopted by the international financial institutions led to retrenchment of public sector employees, economic liberalization and privatization of public enterprises. As a result, there was a drastic decline in employment in the formal sectors, leading to the informal economy gaining prominence.

The expansion of employment in the informal economy has been, for the most part, linked to the slow, if not negative, growth of formal sector-employment. The latter’s lack of dynamism is believed to have been the result of a combination of essentially three factors:

- The rapid and significant growth in the urban labour force, determined by improved living conditions and rural-urban migration;
- Economic stabilization and restructuring programmes, introduced in the early 1980s, which contributed to the decrease in both public sector employment, real wages and salaries; and
- The quest for increased flexibility and deregulation demanded by the growing competitiveness in the global markets, which has resulted in enhanced capital intensity and reduced labour costs.

The magnitude, nature and composition of the informal economy varies between regions and countries, as do the degree of regulation and institutionalization of a country’s economic activities. These include a range of economic activities in urban areas, which are largely owned and operated by single individuals with little capital and labour; a range of economic units that produce and distribute goods and services with a view to generating income and employment; labour-intensive technologies; easy entry; high levels of competition; production of low-quality goods and services; limited capacity for accumulation and restricted access to assets, credit and other services; undeclared and unprotected labour; and unstable relationships of production.

According to the Report of the Director General of the ILO in 2002 on “Decent Work and the Informal Economy”, there is considerable variation

among countries as regards informal employment as a per cent of total employment from 5 to over 70 per cent. The World Labour Report of 1997-98 estimated that in Africa, some 61 per cent of the urban labour force is employed in the informal economy, and is likely to generate some 93 per cent of all additional jobs in Africa in the 1990s. In sub-Saharan African countries, the annual rate of expansion of employment in the urban informal economy was reported to be 6.7 per cent between 1980 and 1985.

Actions on reducing decent work deficits in informal economy in Africa

1. Challenge to the trade unions

Trade unions in Africa are increasingly aware of the growing importance of the informal economy. Trade union membership has been declining rapidly as retrenchment exercises remove thousands of workers from public sector employment. Many, if not most, of these workers shift to the informal economy. This is basically why trade unions are now eyeing the informal economy as a potential source of new membership to shore up their political clout and sagging numerical powers.

However, it is important to realize from the outset that the fundamental differences and constraints between informal and formal sector workers, as well as the organization and objectives of trade unions, do not permit a simple extension of their traditional activities to cover informal economy issues.

All the same, trade unions are in an ideal position to form strategic alliances with the informal sector economy by providing capacity building and other types of support to informal economy organizations. This has been done in Ghana with groups of hairdressers, photographers and transporters. Trade unions are also well placed to dialogue with policy makers, in particular, to ensure that the needs of informal economy workers are clearly articulated while at the same time not undermining the legitimately acquired rights of formal sector workers. This alliance also gives trade unions a potentially greater voice in social and economic decision making.

2. Role of employers' organizations

Employers' organizations can certainly play a pivotal role in the promotion of the modernization of this sector, thus reinforcing its interaction with formal sector enterprises. In fact, some employers' organizations have started to look at small and micro-entrepreneurs as potential sources of new members. In Kenya, Nigeria and Uganda, associations of employers are actively involved in providing useful institutional services to informal economy businesses.

3. Promotion of informal sector associations

Informal workers' associations vary in scope, but are most likely to be either neighbourhood or trade-based, or sometimes a combination of the two, depending on the issues to be addressed, and sometimes in respect of territorially-based political representation. Examples from South India shows that informal economy trade unions have found it necessary to have multiple forms of legal registration in order to address the needs of their informal economy members. The intention has also been to facilitate the flow of donor funds to subsidize their activities, since membership fees can hardly support the organizations' overhead and administration costs, even though they are extremely low. In addition to registering as trade unions, these organizations also had legal status as societies, cooperative credit societies, or as welfare trusts. This enabled them, among others, to start credit and savings societies and welfare services in the areas of maternity benefits, health schemes and improved working conditions. Emulation of these examples depends on the legal framework for registering and regulating non-governmental organizations.

4. Elimination of negative aspects of informality

The decent work deficits are most pronounced in the informal economy. To promote decent work, it is necessary to eliminate the negative aspects of informality while at the same time ensuring that opportunities for livelihood and entrepreneurship are not destroyed, and promoting the protection and incorporation of workers and economic units in the informal economy into the mainstream economy. Continued progress towards recognized, protected decent work will only be possible by identifying and addressing the underlying causes of informality and the barriers to entry into the economic and social mainstream.

5. Primary role of the government

Since decent work deficits are often traceable to good governance deficits, the government has a primary role to play. Political will and commitment and the structures and mechanisms for proper governance are essential. Specific laws, policies and programmes to deal with the factors responsible for informality, to extend protection to all workers, and to remove the barriers to entry into the mainstream economy will vary by country and circumstance. Their formulation and implementation should involve the social partners and the intended beneficiaries in the informal economy.

Informality is principally a governance issue. The growth of the informal economy can often be traced to inappropriate, ineffective, misguided or badly implemented macroeconomic and social policies, often developed without tripartite consultation; the lack of conducive legal and institutional frameworks; and the lack of good governance for proper and effective implementation of policies and laws. Macroeconomic policies, including structural adjustment, economic restructuring and privatization policies, were not sufficiently employment-focused and have reduced jobs or not created adequate new jobs in the formal economy. A lack of high and sustainable economic growth inhibits the capacity of governments to facilitate the transition from the informal to the formal economy through

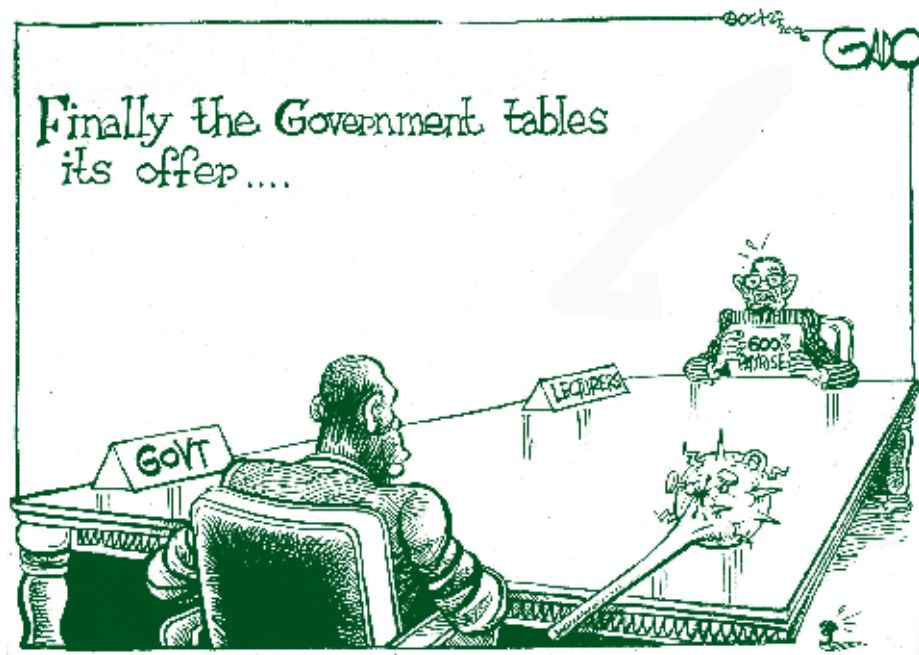
the creation of more jobs in the mainstream economy. Many countries do not have explicit employment creation and business development policies; they treat job quantity and quality as a residual rather than as a necessary factor of economic development.

6. Informal economy as a gender issue

The feminization of poverty and discrimination by gender, age, ethnicity or disability also mean that the most vulnerable and marginalized groups tend to end up in the informal economy. Women generally have to balance the triple responsibilities of breadwinning, domestic chores, and eldercare and childcare. Women are also discriminated against in terms of access to education and training and other economic resources. Thus, women are more likely than men to be in the informal economy.

7. Employment creation and eradication of poverty

Informality can also be traced to a number of other socio-economic factors. Poverty prevents real opportunities and choices for decent and protected work. Low and irregular incomes and often the absence of public policies prevent people from investing in their education and skills needed to boost their own employability and productivity, and from making sustained contributions to social security schemes. Lack of education (primary and secondary) to function effectively in the formal economy, in addition to a lack of recognition of skills garnered in the informal economy, act as another barrier to entering the formal economy. The lack of livelihood opportunities in rural areas drives migrants into informal activities in urban areas or other countries. The HIV/AIDS pandemic—by illness, discrimination or loss of adult breadwinners—pushes families and communities into poverty and survival through informal work.

(q) Africa foreign debt burden

Daily Nation, 27 January 2008. <http://www.gadonet.com>

"All that we had borrowed up to 1985 or 1986 was around \$5 billion and we have paid about \$16 billion yet we are still being told that we owe about \$28 billion. That \$28 billion came about because of the injustice in the foreign creditors' interest rates. If you ask me what is the worst thing in the world, I will say it is compound interest."

*Olusegun
Aremu Okikiola
Matthew
Obasanjo,
retired Nigerian
Army General
and former
President of
Nigeria (born
1937)*

The external debt crisis engulfing Africa has been a dilemma of most development actors for many years. Africa is said to owe the international community up to US\$ 350 billion. Given the current economic scenario, it is certain that most African countries will not be in position to pay back the loans and also effect meaningful development in their economies. This argument is even more compelling when one considers some of the morally unjust circumstances under which Africa's debt was incurred, ranging from the Apartheid-caused debt, unfair international trade and investment to the corrupt diversion of development finance to Swiss banks. In this regard, urgent solutions need to be sought since debt is at the heart of Africa's stagnation and marginalization.

In 1996, the World Bank, the International Monetary Fund, and major creditor nations recognized the seriousness of the crisis by launching the HIPC (Heavily Indebted Poor Countries) initiative. The initiative was a significant step in that it recognized the impossibility of resolving the crisis just by postponing payments ("rescheduling"). Some debt, creditors acknowledged, would have to be cancelled, including debt owed to the multilateral institutions themselves (almost one-third of Africa's debt). Creditors agreed that, in principle, as much as 80 per cent of external debt could be cancelled.

The unanswered questions, however, were under what conditions, how much, how fast and who would pay for it. Typically, the international financial institutions imposed rigid economic adjustment programmes as a condition for participation in HIPC. By September 1998, only 8 countries, including 5 in Africa, had qualified for debt relief packages, adding up to about \$6.5 billion. Uganda was the only African country that had actually reached the "completion point," receiving about \$650 million in debt reduction.

Although the HIPC initiative was welcomed by debt campaigners, its scope is too narrow, its progress too slow and its priorities too dependent on the will of creditor nations. Calculations are made on the basis of what a country is considered able to pay, and not on what resources they need to combat poverty.

To decide which countries are eligible for debt relief under HIPC, and to evaluate how much needs to be done, international agencies calculate ratios of debt to exports and of debt service to exports. Debt is normally considered “sustainable” if its discounted value (the total reduced by whatever portion is only being paid at lower-than-market rates) is less than two to two-and-a-half times annual exports, and if the payments on principle and interest (“debt service”) are in the range of 20 to 25 per cent of exports. These calculations are intended to estimate the maximum debt that the country is capable of carrying without falling behind on its payments.

These criteria only take into account what is practical in terms of paying back the loans, and does not consider the broader economic or human context. Sustainability should be defined not in narrow accounting terms, but in terms of what is needed for development. Then countries desperately in need of capital to invest in their human and physical resources would not have to spend one-third of their income, or even more, in paying back debt.

The scale of the debt crisis

- In 1970, the world’s poorest countries (roughly 60 countries classified as low-income by the World Bank), owed \$25 billion in debt
- By 2002, this was \$523 billion
- For Africa,
 - In 1970, it was just under \$11 billion
 - By 2002, that was over half, to \$295 billion
- Debt owed to the multilateral institutions such as the IMF and World Bank is currently around \$153 billion
- For the poorest countries, debts to multilateral institutions is around \$70 billion
- \$550 billion has been paid in both principal and interest over the last three decades, on \$540 billion of loans, and yet there is still a \$523 billion dollar debt burden
- Sub-Saharan Africa is the world’s poorest region but carries US\$201 billion in debt, despite repaying more than 90 per cent of the \$294 billion received between 1970 and 2002

- Africa spends up to five times more on debt repayment per person than it spends on healthcare and education for its people
- For every \$1 received in aid grants in 1999, Africa paid back \$1.51 interest on debt.

Sources:

Anup Shah, accessed at <http://http://www.globalissues.org/article/30/the-scale-of-the-debt-crisis>.

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There are many reasons for the debt crisis, both political and economic. During the Cold War, corrupt African leaders were often able to gain financing from major powers anxious to retain their loyalty. The creditors received what they paid for—support in the Cold War. Yet, the debt burden remained for future generations to pay.

In its last 15 years of defending White-minority rule, the Apartheid regime in South Africa accumulated more than \$18 billion in debt, while its regional war forced its neighbours to incur more than \$26 billion in debt.

In the 1960s and 1970s, international lenders readily pushed a high volume of loans on many African states. Neither the lenders nor the borrowers anticipated how high the cost of repayment would rise. For African countries with agricultural exports, both unpredictable prices and natural disasters increased vulnerability to debt, just as for farmers anywhere in the world. World oil price hikes in 1972 and 1979 dramatically raised the cost of imports. Even countries that exported oil and other minerals faced boom and bust cycles that raised the odds of incurring unsustainable debt. When interest rates skyrocketed in the 1980s, interest payments jumped. Trying to pay off more debt with less income allowed unpaid debt to mushroom. With all these factors at work, the impact of every additional mistake in economic policy was multiplied.

The causes of debt

- Apart from the fact that Africa cannot afford to pay, most of the continent's debt is illegitimate and odious
- Creditors indiscriminately lent out money to African countries without considering their credit worthiness or how the monies were used
- The great bulk of Africa's debt was incurred in the context of Cold War politics, with loans being made to governments in exchange for political loyalty
- Corrupt or even illegitimate governments (e.g. Mobutu's regime in Zaire and Apartheid South Africa) borrowed billions in their countries' name to line their pockets and strengthen their security apparatus used to repress the people

(r) Trafficking in persons

Trafficking in persons is a problem which pre-dates the modern era. In Africa, trafficking of persons dates back to the slave trade, which involved abduction and transportation of people across the Atlantic Ocean to the Americas from the 1440s onward. Trafficking in persons is a modern-day slavery occasioned by greed, poverty and poor legislation, with the victims predominantly children, girls and women.

Trafficking in persons, however, does not only occur in Africa and is not only a national phenomenon. People are trafficked across and within national borders into various sectors of domestic economies. They are trafficked into domestic service to work in factories and sweatshops, into the agricultural sector and into sex industries. They are also trafficked as beggars and street vendors and are trafficked to engage in illegal activities such as drug running and housebreaking. They are also trafficked for their organs. In addition, they are trafficked as mail-order brides and for purposes of cross-border adoption. This trafficking can be highly organized as evidenced by the sophisticated networks of international syndicates.

At the international level, causes of trafficking include the vulnerabilities created by conflict, endemic poverty, low levels of education, poor health and particularly HIV/AIDS, lack of access to health and social services, high levels of unemployment, violence, discrimination, lack of laws and policies and problematic implementation of laws and policies in regard to child protection. These factors are not, however, the direct causes of trafficking. Rather, they increase the vulnerability of already disadvantaged populations to trafficking.

Causes of trafficking can also be classified at the macro, meso and micro levels. The macro level covers the broader social, economic, political and ideological factors. The meso factors occur at the level of the family, such as unemployment of caregivers. The micro factors involve individual characteristics or experiences, including abuse by parents, family and the community.

The human rights framework relies upon human rights standards and principles laid out in international treaties, covenants and protocols. Interventions under this framework would work to empower women and children via increased access to health and social services, education, and other support systems to decrease their overall vulnerability.

(s) Economic partnership agreements

In 2000, the European Union and the African, Caribbean and Pacific (ACP) Group of States adopted the Cotonou Agreement, which is a framework trade, aid and political cooperation treaty. It replaced the previous Lomé Convention and provides for a general set of privileged relations between the EU and the ACP countries in matters of market access, technical assistance and other issues. The objective is to facilitate the economic and

political integration of the ACP countries into a liberalized world market over the next 20 years.

Under the Cotonou Agreement, the parties agreed to negotiate a separate set of individual bilateral treaties between the EU and the participating ACP countries. Those individual arrangements—"Economic Partnership Agreements"—will provide specific rights and obligations tailored to six defined clusters of countries.

On 27 September 2002, the European Union and the ACP countries officially opened negotiations on Economic Partnership Agreements (EPAs). These negotiations, which were to take place over 5 years, are aimed at redefining the trade regime between the two groups of countries.

However, from the start of negotiations, the EC and ACP's vision of what a future ACP-EU trade agreement should look like have been very different, especially in the areas of trade liberalization, the Singapore issues (investment, public procurement and competition policy) and development. The ACP have consistently raised concerns about these fundamental differences and tried to resist pressure from the EC. However, the EC is increasingly using its economic and political power to force its own vision of EPAs onto the ACP.

According to African trade union activists, the real reasons for EU obsession on EPAs include the following:

- EU is aggressively seeking market access with all regions of the world—ASEAN, China, India, Gulf states, Mercosur, other American countries, and ACP.
- Africa is a major target for strategic considerations—energy, immigration, disease, and its increasing regional and global role with the transition to the AU.
- EU is re-positioning itself as a world power after the end of the Cold War to use its power for good or bad.
- Triumph of economic liberalism in the 1980s and 1990s, and increasing influence of certain institutions and big business, led to focus on global strategies rather than only the traditional economic patterns, and the need to drop the ACP burden.

Update on EPA negotiations: Where do we stand?

ALL ACP

If all had gone to plan, EPAs were supposed to have been neatly concluded in advance of the EU General Affairs and External Relations Council on 20 November 2007. However, not one single EPA had been concluded. By the time of the Kampala Conference, under half of the 77 ACP countries had signed 'interim' agreements and pledged to continue talks in 2008.

Most did so individually or as small groups of countries, rather than as part of the cohesive regional EPA groupings originally designed. The only exception is the Caribbean, which initialed a full and comprehensive EPA with the Commission on 15 December 2007.

CARIFORUM

A CARIFORUM-EC EPA was initialed on 16 December 2007.

PACIFIC

The Pacific ACP (PACP)—where 7 million people live in 14 island countries, spread across 20 million km² of the most remote ocean in the world. On 14 November 2007, only Papua New Guinea and Fiji signed an interim EPA in Brussels. The interim EPA does not provide for the promotion of regional integration or the provision of assistance to support needed reforms.

EAST AFRICA

The five countries belonging to the East African Community (Kenya, Tanzania, Uganda, Rwanda and Burundi) initialed an 'interim' goods-only trade pact with EU on 23 November 2007. The European Commission initialed a 'two step' Economic Partnership Agreement with the Seychelles and Zimbabwe of the Eastern and Southern Africa (ESA) region in Brussels on 28 November 2007.

SOUTHERN AFRICA

Negotiators from the European Commission and several countries from the Southern African Development Community (SADC) initialed an interim Economic Partnership Agreement on 23 November 2007. Botswana, Lesotho, Swaziland and Mozambique gave the deal the green light, while Angola stated it wished to join as soon as possible. Namibia at first refused, but last minute discussions led it to initial on 12 December 2007.

CENTRAL AFRICA

An interim agreement between Cameroon and the EU was initialed on 17 December 2007.

Analytical and empirical evidence on potential impacts of EPAs on Africa

1. *EPAs to exacerbate strain on fiscal systems in Africa*

COMESA study: If all EU imports were duty free, COMESA would lose 25 per cent of their trade taxes and 6 per cent of total tax revenue.

Other studies: Tanzania would lose 37 per cent of public revenue; Namibia would lose 24 per cent of public revenue.

UNECA study: Public revenue losses in Africa would amount to US\$ 2.9 billion, with ECOWAS alone losing US\$ 980 million.

Study by the Nigerian Institute of International Affairs: Nigeria will lose an average of US\$ 478.4 million in 2008 if it implements the degree of import liberalization demanded by EU. The revenue loss would trickle down to an average of US\$ 341 million in the 2020 (constituting 39% of total non-oil revenue).

2. *Undiversified economic structures to face unprecedented challenges*

UNECA Study: European exports will grow by more than US\$ 4 billion in Africa, inducing US\$ 0.8 billion trade displacement. US\$ 48 million of regional trade will be replaced by European imports.

3. *Will consumers benefit from EPAs?*

EPAs could lead to the replacement of an efficient producer from the rest of the world by a less efficient European exporter.

However, other studies show significant improvements for consumers.

In order to ensure that comprehensive EPAs adhere to the pro-development tools requirement, the following pre-conditions need to be met:

- Trade unions as key non-state actors should be rightfully integrated in the national and regional negotiation frameworks.
- Trade unions should proactively seek to participate in all relevant forums and bring their negotiating skills to bear on the outcome of the comprehensive EPAs negotiations.
- There is need to institute a follow-up mechanism to monitor and evaluate how effectively trade unions are participating in the negotiations and implementing key recommendations from their meetings.
- Seek the assistance of key collaborators (including the academia) to assist in undertaking technical assessment of the potential implications of the EPAs.
- Development targets and indicators with clear roles for the EU and the African countries should be integrated in the agreements.
- It is suicidal for ACP countries not to safeguard the original spirit of the Cotonou agenda. The ACP Grouping was brought together by historical accident in 1975 to provide a collective voice and solidarity in dealing with European powers and to promote a New International Economic Order.

Position of the international trade union confederation (ITUC) on EU-Africa Economic Partnership Agreements

- European and African nations should re-negotiate interim EPAs—or negotiate EPAs for those countries that have not initialed any so far—so as to make them strictly WTO-compatible.
- The interpretation given to Article 24 of GATT (referring to the need to liberalize “substantially all trade” (which has been interpreted by industrialized countries as meaning 90 per cent liberalization in trade in goods) which sets out the conditions Free Trade Agreements (FTA) must fulfill to be WTO legal does not take into account developing countries’ particular needs and constraints.
- It is in the interest of European and African nations that EPAs become real instruments for the development of ACP regions. Many doubts have been cast on the development potential of current interim EPAs.
- The EPAs should support endogenous regional integration processes defined by ACP states and their regional bodies.
- EPAs should be made transparent.

If the above mentioned recommendations are not taken into consideration, there would be little development prospects and, in fact, the EPAs would have the risk of increasing poverty in the continent.

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Glossary of economics and political economy terms

Absolute advantage: A country has an absolute advantage if its output per unit of input of all goods and services produced is higher than that of another country.

Ad valorem tax (in Latin: to the value added): A tax based on the value (or assessed value) of property. Ad valorem tax can also be levied on imported items.

Aggregate demand: The sum of all demand in an economy. This can be computed by adding the expenditure on consumer goods and services, investment, and net exports (total exports minus total imports).

Aggregate income: Measure of the total income earned by all sectors in the economy, including private households, government and private business.

Aggregate supply: The total value of the goods and services produced in a country, plus the value of imported goods less the value of exports.

Appropriate technology: Is technology that is designed with special consideration to the environmental, ethical, cultural, social and economical aspects of the community it is intended for.

Asset: Anything of monetary value that is owned by a person. Assets include real property, personal property, and enforceable claims against others (including bank accounts, stocks, mutual funds, and so on).

Authoritarian: A form of abuse of power in which a certain leader or group assumes unlimited power.

Authority: Power that is widely recognized as just and legitimate.

Average propensity to consume: The proportion of income the average family spends on goods and services.

Average propensity to save: The proportion of income the average family saves (does not spend on consumption).

Average total cost: The sum of all the production costs divided by the number of units produced.

Balance of payments: The total of all the money coming into a country from abroad, less all the money going out of the country during the same period. This is usually broken down into the current account and the capital account.

Balance of trade: The difference in value over a period of time between a country's imports and exports.

Barriers to trade: Impediments to international trade erected by government. They include tariffs and non-tariff barriers such as quotas, health and safety requirements, licences, among others.

Barter system: System where there is an exchange of goods without involving money.

Base year: In the construction of an index, the year from which the weights assigned to the different components of the index is drawn. It is conventional to set the value of an index in its base year equal to 100.

Bear: An investor with a pessimistic market outlook; an investor who expects prices to fall and, therefore, sells now in order to buy later at a lower price.

Bid price: The highest price an investor is willing to pay for a stock.

Bill of exchange: A written, dated, and signed three-party instrument containing an unconditional order by a drawer that directs a drawee to pay a definite sum of money to a payee on demand or at a specified future date—also known as a draft. It is the most commonly used financial instrument in international trade.

Birth rate: The number of births in a year per 1000 population.

Bond: A certificate of debt (usually interest-bearing or discounted) that is issued by a government or corporation in order to raise money; the issuer is required to pay a fixed sum annually until maturity and then a fixed sum to repay the principal.

Boom: A state of economic prosperity, as in boom times.

Bourgeoisie: Owners of the means of production.

Break even: A term used to describe a point at which revenues equal costs (fixed and variable).

Bretton Woods: An international monetary system operating from 1946 to 1973. The value of the dollar was fixed in terms of gold, and every other country held its currency at a fixed exchange rate against the dollar. When trade deficits occurred, the Central Bank of the deficit country financed the deficit with its reserves of international currencies. The Bretton Woods system collapsed in 1971 when the US abandoned the gold standard.

Budget deficit: The amount by which government spending exceeds government revenues during a specified period of time, usually a year.

Budget: A summary of intended expenditures along with proposals on how to meet them. A budget can provide guidelines for managing future investments and expenses.

Bull: An investor with an optimistic market outlook; an investor who expects prices to rise and, therefore, buys now for resale later.

Bureaucracy: 'Social machine', which carries out collective tasks, has a hierarchical structure and is staffed by employees. Examples include banks, government departments, and commercial companies.

c.i.f. (abbreviation): Cost, Insurance and Freight: Export term in which the price quoted by the exporter includes the costs of ocean transportation to the port of destination and insurance coverage.

Call money: Price paid by an investor for a call option. There is no fixed rate for call money. It depends on the type of stock, its performance prior to the purchase of the call option, and the period of the contract. It is an interest bearing bank deposits that can be withdrawn on 24 hours notice.

Capital account: Part of a nation's balance of payments that includes purchases and sales of assets, such as stocks, bonds, and land. A nation has a capital account surplus when receipts from asset sales exceed payments for the country's purchases of foreign assets. The sum of the capital and current accounts is the overall balance of payments.

Capital budget: A plan of proposed capital outlays and the means of financing them for the current fiscal period. It is usually a part of the current budget. If a Capital Programme is in operation, it will be the first year thereof. A Capital Programme is sometimes referred to as a Capital Budget.

Capital gain tax: Tax paid on the gain realized upon the sale of an asset. It is a tax on profits from the sale of capital assets, such as shares. A capital loss can be used to offset a capital gain, reducing any tax you would otherwise have to pay.

Capital: Wealth in the form of money or property owned by a person or business and human resources of economic value. Capital is the contribution to productive activity made by investment in physical capital (machinery, factories, tools and equipment) and human capital (e.g. general education, and health). Capital is one of the three main factors of production; the others are labour and natural resources.

Capitalism: A socio-economic system in which the means of production are largely in private hands and the incentive for economic activity is profit.

Capital utilization: A concept in economics, which refers to the extent to which an enterprise or a nation actually uses its installed productive capacity. Thus, it refers to the relationship between potential output that 'could' be produced and actual output that 'is' produced with installed equipment, if capacity was fully used.

Cartel: An organization of producers seeking to limit or eliminate competition among its members, most often by agreeing to restrict output to keep prices higher than would occur under competitive conditions. Cartels are inherently unstable because of the potential for producers to defect from the agreement and capture larger markets by selling at lower prices.

Census: Official gathering of information about the population in a particular area. Government departments use the data collected in planning for the future in such areas as health, education, transport, and housing.

Central bank: Major financial institution responsible for issuing currency, managing foreign reserves, implementing monetary policy, and providing banking services to the government and commercial banks.

Centrally-planned economy: An economic system in which the production, pricing, and distribution of goods and services are determined by the government rather than market forces; also referred to as a “non-market economy.” The former Soviet Union, China, and most other communist nations are examples of centrally-planned economy.

Ceteris paribus: A Latin phrase translated as “with other things the same”. It is commonly rendered in English as “all other things being equal”.

Classical economics: The economics of Adam Smith, David Ricardo, Thomas Malthus, and later followers such as John Stuart Mill. The theory concentrated on the functioning of a market economy, spelling out a rudimentary explanation of consumer and producer behaviour in particular markets and postulating that in the long term, the economy would tend to operate at full employment because increases in supply would create corresponding increases in demand.

Closed economy: An economy in which there are no foreign trade transactions or any other form of economic contact with the rest of the world.

Collateral security: Additional security a borrower supplies to obtain a loan.

Commercial banking: Refers to a bank or a division of a bank that mostly deals with deposit and loans from corporations or large businesses, as opposed to normal individual members of the public (retail banking).

Commercial policy: Encompassing instruments of trade protection employed by countries to foster industrial promotion, export diversification, employment creation, and other desired development-oriented strategies. They include tariffs, quotas, and subsidies.

Commodity: Something produced for sale in order to make a profit.

Comparative advantage: The ability to produce a good at a lower cost, relative to other goods, compared to another country. With perfect

competition and undistorted markets, countries tend to export goods in which they have a comparative advantage and hence make gains from trading.

Compound interest: Interest paid on the original principal and on interest accrued from the time it became due.

Concept: A mental tool which helps us to represent and organize information and to think abstractly about the world around us.

Conditionality: The requirement imposed by the International Monetary Fund that a borrowing country undertake fiscal, monetary, and international commercial reforms as a condition to receiving a loan for balance of payments difficulties.

Conglomerates: Business enterprises that are involved in more than one sector of an economy.

Consumer surplus: The difference between what a consumer would be willing to pay for a good or service and what that consumer actually has to pay. Added to producer surplus, it provides a measure of the total economic benefit of a sale.

Copyright: A legal right (usually of the author or composer or publisher of a work) to exclusive publication, production, sale, distribution of some work. What is protected by the copyright is the “expression,” not the idea. Notice that taking another’s idea is plagiarism; therefore copyrights are not the equivalent of legal prohibition of plagiarism.

Corporate Social Responsibility (CSR): also called corporate responsibility, corporate citizenship, responsible business or corporate social opportunity is a concept whereby organizations consider the interests of society by taking responsibility for the impact of their activities on customers, suppliers, employees, shareholders, communities and other stakeholders, as well as the environment. This obligation is seen to extend beyond the statutory obligation to comply with legislation and sees organizations voluntarily taking further steps to improve the quality of life for employees and their families as well as for the local community and society at large. The practice of CSR is subject to much debate and criticism.

Correlation coefficient: Denoted as “ r ”, is a measure of the linear relationship between two variables. The absolute value of “ r ” provides an indication of the strength of the relationship. The value of “ r ” varies between positive 1 and negative 1, with -1 or 1 indicating a perfect linear relationship, and $r = 0$ indicating no relationship. The sign of the correlation coefficient indicates whether the slope of the line is positive or negative when the two variables are plotted in a scatter plot.

Cost benefit analysis (CBA): A technique that assesses projects through a comparison between their costs and benefits, including social costs and benefits for an entire region or country. Depending on the project objectives and the expected outputs, three types of CBA are generally

recognized: financial, economic, and social. Generally, cost-benefit analysis are comparative, i.e. they are used to compare alternative proposals. Cost-benefit analysis compares the costs and benefits of the situation with and without the project; the costs and benefits are considered over the life of the project.

Countervailing duties: These are duties (tariffs) that are imposed by a country to counteract subsidies provided to a foreign producer current account. Part of a nation's balance of payments, which includes the value of all goods and services imported and exported, as well as the payment and receipt of dividends and interest. A nation has a current account surplus if exports exceed imports plus net transfers to foreigners. The sum of the current and capital accounts is the overall balance of payments.

Cross elasticity of demand: The change in the quantity demanded of one product or service impacting the change in demand for another product or service. For example, the percent change in the quantity demanded of a good divided by the percent change in the price of another good (a substitute or complement).

Crowding out: The possible tendency for government to spend on goods and services in order to put upward pressure on interest rates, thereby discouraging spending in private investment.

Currency appreciation: An increase in the value of one currency relative to another currency. Appreciation occurs when, because of a change in exchange rate, a unit of one currency buys more units of another currency. The opposite is the case with currency depreciation.

Currency board: Form of Central Bank that issues domestic currency for foreign exchange at fixed rates.

Currency substitution: The use of foreign currency as a medium of exchange in place of or along with the local currency.

Customs duty: Duty levied on the imports of certain goods—includes excise equivalents. Unlike tariffs, customs duties are used mainly as a means to raise revenue for the government rather than protecting domestic producers from foreign competition.

Death rate: Numbers of people dying per thousand population.

Deflation: A reduction in the level of national income and output, usually accompanied by a fall in the general price level.

Deregulation: A process by which governments remove, reduce, or simplify restrictions on business and individuals with the intent of encouraging the efficient operation of markets.

Derived demand: Is where demand for one good or service occurs as a result of demand for another. Demand for transport is a good example of derived demand, as users of transport are very often consuming the

service not because they benefit from consumption directly (except in cases such as pleasure cruises), but because they wish to partake in other consumption elsewhere.

Developed country: An economically advanced country whose economy is characterized by a large industrial and service sector and high levels of income per head.

Developing country: A less developed country, under-developed country or third world country; a country characterized by low levels of GDP and per capita income, typically dominated by agriculture and mineral products and majority of the population lives near subsistence levels.

Direct investment: Foreign capital inflow in the form of investment by foreign-based companies into domestic-based companies. Portfolio investment is foreign capital inflow by foreign investors into shares and financial securities. It is the ownership and management of production and or marketing facilities in a foreign country.

Direct tax: A tax that you pay directly, as opposed to indirect taxes, such as tariffs and business taxes. Income tax is a direct tax, as are property taxes.

Double taxation: Corporate earnings taxed at both the corporate level and again as a stockholder dividend.

Duopoly: A market structure in which two producers of a commodity compete with each other.

Dumping: Occurs when goods are exported at a price less than their normal value, generally meaning that they are exported for less than they are sold in the domestic market or third country markets, or at less than production cost.

Econometrics: The application of statistical and mathematical methods in the field of economics to test and quantify economic theories and the solutions to economic problems.

Economic development: The process of improving the quality of human life by increasing per capita income, reducing poverty, and enhancing individual economic opportunities. It is also sometimes defined to include better education, improved health and nutrition, conservation of natural resources, a cleaner environment, and a richer cultural life.

Economic efficiency: Is a general term in economics describing how well a system is performing in generating the maximum desired output for given inputs with available technology.

Economic growth: An increase in the nation's capacity to produce goods and services. Also a quantitative measure of the change in size/volume of economic activity, usually calculated in terms of gross national product (GNP) or gross domestic product (GDP).

Economic infrastructure: The underlying amount of physical and financial capital embodied in roads, railways, waterways, airways, and other forms of transportation and communication, plus water supplies, financial institutions, electricity, and public services such as health and education. The level of infrastructural development in a country is a crucial factor determining the pace and diversity of economic development.

Economic integration: The merging to various degrees of the economies and economic policies of two or more countries in a given region.

Economic policy: A statement of objectives and the methods of achieving these objectives (policy instruments) by government, political party, or business concern. Some examples of government economic objectives are maintaining full employment, achieving a high rate of economic growth, reducing income inequalities and regional development inequalities, and maintaining price stability. Policy instruments include fiscal policy, monetary and financial policy, and legislative controls (e.g. price and wage control, rent control).

Economic rent: Is the difference between what a factor of production is paid and how much it would need to be paid to remain in its current use. There are multiple mechanisms that can create economic rent: political contrivance, network effect, monopoly power, among others.

Economies of scale: Bigger is better. In many industries, as output increases, the average cost of each unit produced falls. One reason is that overheads and other fixed costs can be spread over more units of output. However, getting bigger can also increase average costs (diseconomies of scale) because it is more difficult to manage a big operation, for instance.

Elasticity of demand: The degree to which consumer demand for a product or service responds to a change in price, wage or other independent variable. When there is no perceptible response, demand is said to be inelastic.

Excess capacity: Volume or capacity over and above that which is needed to meet peak planned or expected demand.

Excess demand: The situation in which the quantity demanded at a given price exceeds the quantity supplied. The opposite is excess supply.

Exchange control: A government policy designed to restrict the outflow of domestic currency and prevent a worsened balance of payments position by controlling the amount of foreign exchange that can be obtained or held by domestic citizens. Often results from overvalued exchange rates.

Exchange control: A governmental policy designed to restrict the outflow of domestic currency and prevent a worsened balance of payments position by controlling the amount of foreign exchange that can be obtained or held by domestic citizens; often results from overvalued exchange rates.

Exchange rate: The price of one currency stated in terms of another currency, when exchanged.

Exploitation: The process by which the surplus retained by the owners of the means of production is greater than the value of the workers' labour. The worker is exploited if he or she does not get the full value of his or her worth from a production process.

Export incentives: Public subsidies, tax rebates, and other kinds of financial and non-financial measures designed to promote a greater level of economic activity in export industries.

Exports: The value of all goods and non-factor services sold to the rest of the world; they include merchandise, freight, insurance, travel, and other non-factor services. The value of factor services (such as investment receipts and workers' remittances from abroad) is excluded from this measure—see also merchandise exports and imports.

Externalities: A cost or benefit not accounted for in the price of goods or services. Often, "externality" refers to the cost of pollution and other environmental impacts.

Fiscal deficit: The gap between the government's total spending and the sum of its revenue receipts and non-debt capital receipts. It represents the total amount of borrowed funds required by the government to completely meet its expenditure.

Fiscal policy: The use of government expenditure and taxation to try to influence the level of economic activity. An expansionary (or reflationary) fiscal policy could mean cutting levels of direct or indirect tax, or increasing government expenditure. The effect of these policies would be to encourage more spending and boost the economy. A contractionary (or deflationary) fiscal policy could be increasing taxation—either direct or indirect cutting of government expenditure. These policies would reduce the level of demand in the economy and help reduce inflation.

Fixed costs: A cost incurred in the general operations of the business that is not directly attributable to the costs of producing goods and services. These "Fixed" or "Indirect" costs of doing business will be incurred whether or not any sales are made during the period, thus the designation "Fixed", as opposed to "Variable".

Fixed exchange rate: The exchange value of a national currency fixed in relation to another (usually the US dollar), not free to fluctuate on the international money market.

Foreign aid: The international transfer of public funds in the form of loans or grants either directly from one government to another (bilateral assistance) or indirectly through the vehicle of a multilateral assistance agency such as the World Bank.

Foreign direct investment (FDI): Overseas investments by private multinational corporations.

Foreign exchange reserves: The stock of liquid assets denominated in foreign currencies held by a government's monetary authorities (typically, the finance ministry or Central Bank). Reserves enable the monetary authorities to intervene in foreign exchange markets to affect the exchange value of their domestic currency in the market. Reserves are invested in low-risk and liquid assets, often in foreign government securities.

Free trade: Trade in which goods can be imported and exported without any barriers in the forms of tariffs, quotas, or other restrictions. Free trade has often been described as an engine of growth because it encourages countries to specialize in activities in which they have comparative advantages, thereby increasing their respective production efficiencies and hence their total output of goods and services.

Free-market exchange rate: Rate determined solely by international supply and demand for domestic currency expressed in terms of, say, US dollars.

Free-trade area: A form of economic integration in which there exists free internal trade among member countries, but each member is free to levy different external tariffs against non-member nations.

Fringe benefit: A benefit in addition to salary offered to employees, such as use of company's car, house, lunch coupons, and healthcare subscriptions.

Gains from trade: The addition to output and consumption resulting from specialization in production and free trade with other economic units, including persons, regions, or countries.

Gender: The socially-defined relationships between men and women in all areas of social, economic and political life.

General Agreement on Tariffs and Trade (GATT): An international body set up in 1947 to probe into the ways and means of reducing tariffs on internationally traded goods and services. Between 1947 and 1962, GATT held seven conferences but met with only moderate success. Its major success was achieved in 1967 during the so-called Kennedy Round of talks when tariffs on primary commodities were drastically slashed and then in 1994 with the signing of the Uruguay Round agreement. GATT was replaced in 1995 by World Trade Organization (WTO).

Global warming theory: Theory that the world climate is slowly warming as a result of both MDC and LDC industrial and agricultural activities.

Global warming: The increase in the average measured temperature of the Earth's near-surface air and oceans since the mid-20th century, and its projected continuation.

Globalization: A trend by which a multiplicity of inter-connections link people and societies across the globe into closer communication with one another. It is also seen as the process whereby trade is now being conducted on ever widening geographical boundaries. Countries now trade across continents and companies also trade all over the world.

Global Union Federations: An international federation of national and regional trade unions organizing in specific industry sectors or occupational groups, previously known as international trade secretariats (ITCs). Most major unions are members of one or more global union federations relevant to the sectors where they have their members. Normally, the individual union will also be affiliated to a national trade union centre, which in turn can be affiliated to a world body such as the International Trade Union Confederation (ITUC).

Gross domestic product (GDP): The total of goods and services produced by a nation over a given period, usually one year. Gross Domestic Product measures the total output from all the resources located in a country, wherever the owners of the resources live.

Gross national product (GNP): The value of all final goods and services produced within a nation in a given year, plus income earned by its citizens abroad, minus income earned by foreigners from domestic production. GNP equals GDP plus net property income from abroad.

Household: Group of people who may or may not be related, who live under one roof and co operate in everyday domestic and economic matters.

Human capital productive investments: Investments embodied in human persons. These include skills, abilities, ideals, and health resulting from expenditures on education, on-the-job training programmes, and medical care.

Imperfect competition: A market situation or structure in which producers have some degree of control over the price of their product. Examples include monopoly and oligopoly.

Imperfect market: A market where the theoretical assumptions of perfect competition are violated by the existence of, for example, a small number of buyers and sellers, barriers to entry, non-homogeneity of products, and incomplete information. The three imperfect markets commonly analyzed in economic theory are monopoly, oligopoly, and monopolistic competition.

Import substitution: A deliberate effort to replace major consumer imports by promoting the emergence and expansion of domestic industries such as textiles, shoes, and household appliances. Import substitution requires the imposition of protective tariffs and quotas to get the new industry started.

Income inequality: The existence of disproportionate distribution of total national income among households, whereby the share going to rich persons in a country is far greater than that going to poorer persons (a situation common to most LDCs). This is largely due to differences in the amount of income derived from ownership of property and to a lesser extent the result of differences in earned income. Inequality of personal incomes can be reduced by progressive income taxes and wealth taxes.

Index of industrial production: A quantity index that is designed to measure changes in the physical volume or production levels of industrial goods over time.

Indirect tax: A tax you do not pay directly, but which is passed on to you by an increase in your expenses. For instance, a company might have to pay a fuel tax. The company pays the tax but can increase the cost of its products so that consumers are actually paying the tax indirectly by paying more for the merchandise.

Inflation: The percent increase in the prices of goods and services.

Intellectual property: A legal field that refers to creations of the mind, such as musical, literary, and artistic works; inventions; and symbols, names, images and designs used in commerce, including copyrights, trademarks, patents and related rights. Under intellectual property law, the holder of one of these abstract “properties” has certain exclusive rights to the creative work, commercial symbol, or invention by which it is covered.

Interdependence/Interrelationship: Between economic and non-economic variables, and also in international affairs means a situation in which one nation’s welfare depends, to varying degrees, on the decisions and policies of another nation, and vice versa.

International commodity agreement: Formal agreement by sellers of a common internationally traded commodity (coffee, sugar) to co ordinate supply to maintain price stability.

International Labour Organization (ILO): One of the functional organizations of the United Nations, based in Geneva, Switzerland, whose central task is to look into problems of world labour supply, its training, utilization, domestic and international distribution. Its aim in this endeavour is to increase world output through maximum utilization of available human resources and thus improve levels of living.

International Monetary Fund (IMF): An autonomous international financial institution that originated in the Bretton Woods Conference of 1944. Its main purpose is to regulate the international monetary exchange system, which also stems from that conference but has since been modified. In particular, one of the central tasks of the IMF is to control fluctuations in exchange rates of world currencies in a bid to alleviate severe balance of payments problems.

International poverty line: An arbitrary international real income measure, usually expressed in constant dollars (e.g. \$270), used as a basis for estimating the proportion of the world's population that exists at bare levels of subsistence.

Land reform: A deliberate attempt to reorganize and transform existing agrarian systems with the intention of improving the distribution of agricultural incomes and thus fostering rural development. Among its many forms, land reform may entail provision of secured tenure rights to the individual farmer, transfer of land ownership away from small classes of powerful landowners to tenants who actually till the land, appropriation of land estates for establishing small new settlement farms, or instituting land improvements and irrigation schemes.

Law of diminishing returns: In economics, diminishing returns is also called diminishing marginal returns or the law of diminishing returns. According to this relationship, in a production system with fixed and variable inputs (say factory size and labour), beyond some point, each additional unit of variable input yields less and less additional output. Conversely, producing one more unit of output costs more and more in variable inputs. This concept is also known as the law of increasing relative cost, or the law of increasing opportunity cost. Although ostensibly a purely economic concept, diminishing marginal returns also implies a technological relationship.

Macroeconomic stabilization policies: Policies designed to eliminate macroeconomic instability.

Macroeconomics: The branch of economics that considers the relationships among broad economic aggregates such as national income, total volumes of saving, investment, consumption expenditure, employment, and money supply. It is also concerned with determinants of the magnitudes of these aggregates and their rates of change over time.

Marginal product (or marginal physical product): Is the extra output produced by one more unit of an input (for instance, the difference in output when a firm's labour is increased from five to six units). Assuming that no other inputs to production change, the marginal product of a given input (X) can be expressed as: $Y = \Delta Y / \Delta X = (\text{the change of } Y) / (\text{the change of } X)$.

Marginal rate of substitution: Is the rate at which a customer is ready to give up one good in exchange for another good while maintaining the same level of satisfaction.

Marginal revenue product of labour: Is the additional income generated by using one more unit of work.

Marginal revenue: Is the extra revenue that an additional unit of product will bring. It can also be described as the change in total revenue/change in number of units sold. More formally, marginal revenue is equal to the

change in total revenue over the change in quantity when the change in quantity is equal to one unit (or the change in output in the bracket where the change in revenue has occurred).

Market economy: A free private-enterprise economy governed by consumer sovereignty, a price system, and the forces of supply and demand.

Market failure: A phenomenon that results from the existence of market imperfections (e.g. monopoly power, lack of factor mobility, significant externalities, lack of knowledge) that weaken the functioning of a free-market economy; it fails to realize its theoretical beneficial results. Market failure often provides the justification for government interference with the working of the free market.

Market mechanism: The system whereby prices of commodities or services freely rise or fall when the buyer's demand for them rises or falls when the seller's supply of them decreases or increases.

Market prices: Prices established by demand and supply in a free-market economy.

Market-friendly approach: World Bank notion that successful development policy requires governments to create an environment in which markets can operate efficiently and to intervene selectively in the economy in areas where the market is inefficient (e.g. in social and economic infrastructure, investment co ordination, and economic "safety net").

Merchandise exports and imports: All international changes in ownership of merchandise passing across the customs borders of the trading countries. Exports are valued f.o.b. (free on board). Imports are valued c.i.f. (cost, insurance, and freight).

Merchandise trade balance: Balance on commodity exports and imports.

Microeconomics: The branch of economics concerned with individual decision units—firms and households—and the way in which their decisions interact to determine relative prices of goods and factors of production and how much of these will be bought and sold. The market is the central concept in microeconomics.

Middle-income countries (MICs): Less developed countries with per capita income above \$785 and below \$9,655 in 1997, according to World Bank measures.

Minimum wage: The lowest hourly, daily, or monthly wage that employers may legally pay to employees or workers.

Mixed economic systems: Economic systems that are a mixture of both capitalist and socialist economies. Most developing countries have mixed

systems. Their essential feature is the coexistence of substantial private and public activity within a single economy.

Monetary policy: The regulation of money supply and interest rates by a Central Bank in order to control inflation and stabilize currency. If the economy is heating up, the Central Bank can withdraw money from the banking system, raise the reserve requirement or raise the discount rate to make it cool down. If growth is slowing, it can reverse the process— increase money supply, lower the reserve requirement and decrease the discount rate. The monetary policy influences interest rates and money supply.

Money supply: The total stock of money in the economy; currency held by the public plus money in accounts in banks. It consists primarily of currency in circulation and deposits in savings and checking accounts. Too much money in relation to the output of goods tends to push interest rates down and push inflation up; too little money tends to push rates up and prices down, causing unemployment and idle plant capacity. The Central Bank manages money supply by raising and lowering the reserves banks are required to hold and the discount rate at which they can borrow money from the Central Bank. The Central Bank also trades government securities (called repurchase agreements) to take money out of the system or put it in. There are various measures of money supply, including M1, M2, M3 and L. These are referred to as monetary aggregates.

Monopoly: A market situation in which a product that does not have close substitutes is being produced and sold by a single seller.

Multi-Fibre Arrangement (MFA): A set of non-tariff bilateral quotas established by developed countries on imports of cotton, wool, and synthetic textiles and clothing from individual less developed countries.

Multinational Corporation (MNC): An international or transnational corporation with headquarters in one country but with branch offices in a wide range of both developed and developing countries. Examples include General Motors, Coca Cola, Firestone, Philips, Volkswagen, British Petroleum, and Exxon. Firms become multinational corporations when they perceive advantages to establishing production and other activities in foreign locations. Firms globalize their activities both to supply their home-country market more cheaply and to serve foreign markets more directly. Keeping foreign activities within the corporate structure lets firms avoid the costs inherent in arm's-length dealings with separate entities while utilizing their own firm-specific knowledge, such as advanced production techniques.

National debt: Treasury bills, notes, bonds, and other debt obligations that constitute the debt owed by the federal government. It represents the accumulation of each year's budget deficit.

Newly industrializing countries (NICs): A small group of countries at a relatively advanced level of economic development, with a substantial and dynamic industrial sector and with close links to international trade,

finance, and investment system, for example Argentina, Brazil, Greece, Mexico, Portugal, Singapore, South Korea, Spain, and Taiwan.

Non-governmental organizations (NGOs): Privately-owned and operated organizations involved in providing financial and technical assistance to least developed countries.

Non-tariff trade barrier: A barrier to free trade that takes a form other than a tariff, such as quotas or sanitary requirements for imported meats and dairy products.

Official development assistance (ODA): Net disbursements of loans or grants made on concessional terms by official agencies of member countries of the Organization for Economic Cooperation and Development (OECD).

Official exchange rate: Rate at which the Central Bank will buy and sell domestic currency in terms of a foreign currency such as the US dollar.

Open economy: An economy that encourages foreign trade and has extensive financial and non-financial contacts with the rest of the world in areas such as education, culture, and technology.

Organization for Economic Cooperation and Development (OECD): An organization of 20 countries from the western world including all of those in Europe and North America. Its major objective is to assist the economic growth of its member nations by promoting cooperation and technical analysis of national and international economic trends.

Over-valued exchange rate: An official exchange rate set at a level higher than its real or shadow value, for example 7 Kenyan shillings per dollar instead of, say, 10 shillings per dollar. Over-valued rates cheapen the real cost of imports while raising the real cost of exports. They often lead to a need for exchange control.

Pareto efficiency or Pareto optimality: An important concept in economics with broad applications in game theory, engineering and the social sciences. The term is named after Vilfredo Pareto, an Italian economist who used the concept in his studies of economic efficiency and income distribution.

Perfect competition: A market situation characterized by the existence of very many buyers and sellers of homogeneous goods or services with perfect knowledge and free entry, so that no single buyer or seller can influence the price of the good or service.

Performance budget: A budget format that relates the input of resources and the output of services for each organizational unit individually; sometimes used synonymously with programme budget. It is a budget wherein expenditures are based primarily upon measurable performance of activities.

Petit bourgeoisie: Intermediate classes who aspire to be like the bourgeoisie. This class includes doctors, lawyers, minor business people and skilled labour.

Political economy: The attempt to merge economic analysis with practical politics—to view economic activity in its political context. Much of classical economics was political economy and, today, political economy is increasingly being recognized as necessary for any realistic examination of development problems.

Portfolio investment: Financial investments by private individuals, corporations, pension funds, and mutual funds in stocks, bonds, certificates of deposit, and notes issued by private companies and public agencies of least developed countries.

Poverty gap: The sum of the difference between the poverty line and actual income levels of all people living below that line.

Poverty line: A level of income below which people are deemed poor. A global poverty line of \$1 per person per day was suggested in 1990 by the World Bank. This line facilitates comparison of how many poor people there are in different countries. However, it is only a crude estimate because the line does not recognize differences in the buying power of money in different countries and, more significantly, because it does not recognize other aspects of poverty than the material, or income poverty.

Power: A relationship that determines the ability of someone to do something (power to), or the ability to make someone else do one's bidding (power over).

Price elasticity of demand: The responsiveness of the quantity of a commodity demanded to a change in its price, expressed as the percent change in quantity demanded divided by the percent change in price.

Price elasticity of supply: The responsiveness of the quantity of a commodity supplied to a change in its price, expressed as the percent change in quantity supplied divided by the percent change in price.

Price: The monetary or real value of a resource, commodity, or service. The role of prices in a market economy is to ration or allocate resources in accordance with supply and demand; relative prices should reflect the relative scarcity of different resources, goods, or services.

Primary sector: That sector of an economy in which natural resources are exploited, e.g. particular market.

Producer surplus: The difference between what a supplier is paid for a good or service and what it cost to supply. Added to consumer surplus, it provides a measure of the total economic benefit of a sale.

Proletarianization: The process of turning people into wage labourers, especially from a peasantry where feudal relations of production have been removed.

Proletariat: The working class; those actively engaged in productive labour.

Public debt: Internal and external borrowings by the government. The total of the nation's debts—debts of local and state and national governments—is an indicator of how much public spending is financed by borrowing instead of taxation.

Quota: A physical limitation on the quantity of any item that can be imported into a country, such as so many automobiles per year. Also a method for allocating limited school places by non-competitive means, for example by income or ethnicity.

Repo rate: One of the credit management tools used by the Reserve Bank to regulate liquidity (customer spending). The bank borrows money from the Reserve Bank to cover its shortfall. The Reserve Bank only makes a certain amount of money available and this determines the repo rate. If the bank requires more money than what is available, this will increase the repo rate, and vice versa.

Revenue expenditure: This is expenditure on recurring items, including the running of services and financing capital spending that is paid for by borrowing. This is meant for normal running of governments' maintenance expenditures, interest payments, subsidies and transfers. It is current expenditure that does not result in the creation of assets. Grants given to state governments or other parties are also treated as revenue expenditure even if some of the grants may be meant for creating assets.

Revenue receipts: Additions to assets that do not incur an obligation that must be met at some future date and do not represent exchanges of property for money. Assets must be available for expenditures. These include proceeds of taxes and duties levied by the government, interest and dividend on investments made by the government, fees and other receipts for services rendered by the government.

Secondary sector: The sector of an economy in which goods are manufactured.

Stabilization policies: A coordinated set of mostly restrictive fiscal and monetary policies aimed at reducing inflation, cutting budget deficits, and improving the balance of payments.

Subsidy: A payment by the government to producers or distributors in an industry to prevent the decline of that industry (e.g. as a result of continuous unprofitable operations) or an increase in the prices of its products or simply to encourage it to hire more labour (as in the case of a wage subsidy). Examples are export subsidies to encourage the sale of exports; subsidies on some foodstuffs to keep down the cost of living,

especially in urban areas; and farm subsidies to encourage expansion of farm production and achieve self-reliance in food production.

Sustainable development: A kind of economic development, which attempts to meet people's basic needs while preserving the resource base of the society.

Tax avoidance: A legal action designed to reduce or eliminate the taxes that one owes.

Tax base: The total property and resources subject to taxation.

Tax evasion: An illegal strategy to decrease tax burden by under-reporting income, overstating deductions, or using illegal tax shelters.

Terms of trade: The ratio of a country's average export price to its average import price, also known as the commodity terms of trade. A country's terms of trade are said to improve when this ratio increases and to worsen when it decreases; that is, when import prices rise at a relatively faster rate than export prices (the experience of many least developed countries in recent decades).

Trade union, or labour union: Is an organization of workers who have banded together to achieve common goals in key areas such as wages, hours, and working conditions.

Transfer of payments: Is payment of money from a government to an individual for which no good or service is required in return.

Treasury bill: A short-term debt issued by a national government with a maximum maturity of one year. Treasury bills are sold at discount, such that the difference between purchase price and the value at maturity is the amount of interest.

Value of marginal product: Is the marginal physical output of a factor input multiplied by the unit price of the output. It is a measure of a firm's revenue contributed by the last unit of a productive factor employed.

Variable: Is an attribute of a physical or an abstract system, which may change its value while it is under observation. Examples include the height of a child, the temperature across a state, or the input to a function. The concept variable is used in all areas of mathematics, science and engineering.

VAT: A form of indirect sales tax paid on products and services at each stage of production or distribution, based on the value added at that stage and included in the cost to the ultimate customer.

Wage: Is a compensation workers receive in exchange for their labour.
World Bank: An international financial institution owned by its 181 member countries and based in Washington DC. Its main objective is to provide development funds to Third World nations in the form of interest-bearing loans and technical assistance. The World Bank operates with borrowed funds.

WTO: The World Trade Organization is a global international organization dealing with the rules of trade between nations. It was set up in 1995 at the conclusion of GATT negotiations for administering multilateral trade negotiations.

X-efficiency: The effectiveness with which a given set of inputs are used to produce outputs. If a firm is producing the maximum output it can, given the resources it employs, such as men and machinery, and the best technology available, it is said to be x-efficient. X-inefficiency occurs when x-efficiency is not achieved. The concept of x-efficiency was introduced by Harvey Leibenstein (1922-1994), a Ukrainian born American economist.

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