Edexcel

A Level

Economics

(Code: WEC11 01)

Unit 04-Section 6

Growth and development and developing, emerging and developed economics

GROWTH VS DEVELOPMENT

In the 1950s and 1960s, there was an assumption among economists that economic growth and economic development were closely linked. High economic growth would lead to fast economic development and vice versa. Economic growth is relatively simple to measure. It is the rate of change of national income, as measured.

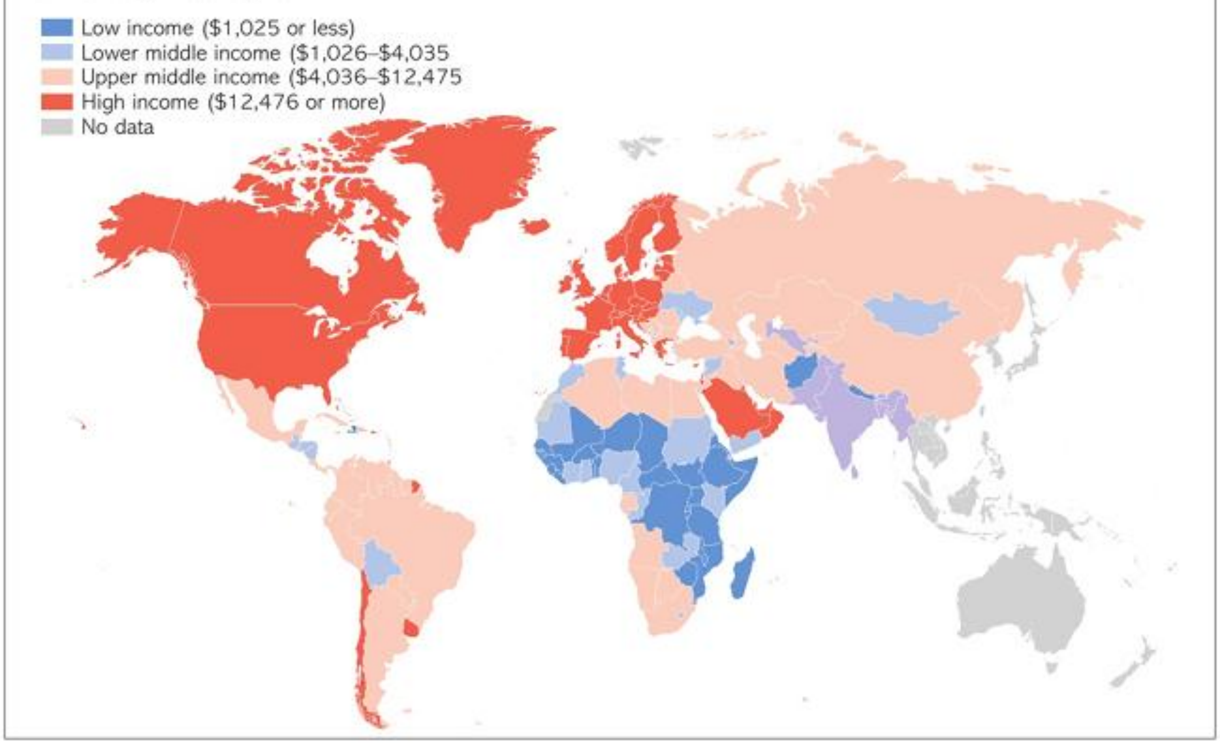
Because the measurement of well-being, quality of life and living standards is complex, economic development is measured based on a variety of **indicators of development**.

CLASSIFICATION OF COUNTRIES

Countries differ in their level of economic development. Economists, politicians, government agencies and world organisations, such as the World Bank, the IMF and the OECD, classify countries and band them into groups for various purposes, an example of which is aid disbursement. Examples of these classifications include the following.

FIGURE 1

The world by income, 2017



High-income, middle-income and low-income countries One simple way to classify countries is by their income. Countries differ in size of population. So the key indicator is income per capita. To eliminate exchange rate issues and differences in costs of living, income per capita can be measured in terms of purchasing power parities (PPPs).

Developed, developing and less developed countries Developed countries are high-income countries, such as the UK and the US. Developing or less developed countries are broadly middle-income and low-income countries. Low-income countries are sometimes called least developed countries.

Other classifications There are many other terms used to describe countries, for example:

• Emerging countries - middle-income countries which could become high-income countries over the next 20 or 30 years. Another term used to describe this group is newly industrialised countries (NICs).

• BRIC countries - four countries: Brazil, India, Russia and China. When this term was first used, in the early 2000s, it was judged that these countries were very large, but also had high growth prospects. As such, their growth would be very important for the whole world economy.

• Tiger economies - economies with very high growth rates, such as have been experienced by South Korea, Singapore, Hong Kong and Taiwan in the past.

CHARACTERISTICS OF DEVELOPING COUNTRIES

Lower per capita incomes Output per person, measured in money terms, and incomes received by citizens on average are lower than in developed countries.

Physical capital Developing countries have less physical capital per capita than developed countries. This means there is less infrastructure, such as roads, offices, hospitals and schools per capita.

Human capital Developing countries, on average, have lower levels of human capital. On average, the population is less well educated and skilled than in developed countries. In poorer developing countries, for example, illiteracy rates might be high and might differ significantly between genders.

Health and mortality Individuals in developing countries on average suffer poorer health and die younger than in developed countries. Health is greatly influenced by living conditions. In developing countries, individuals are less likely to have access to safe drinking water, while they are more likely to have no proper sanitation facilities, live in cramped conditions, not have enough to eat and have limited access to medical facilities.

Population growth Population growth tends to be linked to average incomes. The higher the average income, the lower the rate of population growth is likely to be. One reason is that in low-income countries, children can be put to work and bring income into the family. They can also look after the parents in old age.

Unemployment and underemployment Less physical and human capital, combined with high population growth, can lead to large scale unemployment and underemployment.

Structure of the economy As economies develop, typically they pass through the same restructuring of their economies. In less developed economies, the agricultural sector is large, while manufacturing is small.

Institutional structures Developed countries have a complex system of institutional structures. There is 'good' government, independent judges, a strong set of laws that protect private property and a sophisticated financial system.

The environment- A growing population, together with growth of agriculture, mining and manufacturing, mean that the environment is under greater pressure in developing countries than in developed countries. There is often mass migration of people from the countryside to towns and cities. In rich developed countries there is sufficient income to protect the environment and make it cleaner.

MEASURES OF ECONOMIC DEVELOPMENT

Growth in GDP/GNI per capita is a useful indicator of development as it is a single measure using the same unit, money. However, economists argue that it overlooks many aspects of development, such as access to mobile phones, energy consumption, and schooling. Instead, an index with specific weightings can be used, such as the Producer Price Index or Consumer Prices Index.

THE HUMAN DEVELOPMENT INDEX

The United Nations calculates a measure of economic development called the Human Development Index (HDI). This is a composite index based on three dimensions or components of development. The three dimensions of development are measured using four indicators:

- health, as measured by life expectancy at birth
- education, as measured by two indicators: the mean (i.e. average) years of schooling of adults aged 25 and over; and the expected years of schooling that current five-year-olds can expect to receive over their lives
- income as measured by real gross national income (GNI) per capita at purchasing power parities.

Advantages of the HDI

• The Human Development Index gives a broader measure of economic development than national income statistics, such as GNI per capita. As the United Nations states, 'Income is a means to human development, and not the end'. The HDI measures three important dimensions of human development: a long and healthy life (measured by life expectancy at birth), having knowledge (measured by mean and expected years of schooling) and having a decent material standard of living (measured by GNI per capita).

- It is also recognised in the method of calculating the HDI, that increases in income have a diminishing impact on living standards. For example, a rise in GNI per capita of $100 will have a greater impact on improving living standards in a country where average income is only $500, than in a country where average income is $5000 or $50,000.
- Using HDI values helps policy makers to assess how well their economic growth is benefiting their citizens, for these important dimensions of human development.
- Because the HDI has only three components, it is relatively easy to calculate because governments tend to collect the statistics used in the index. The HDI value is well understood as a measure of development. Most policy makers understand

LIMITATIONS OF THE HDI

The HDI only uses four indicators to measure the three components of health, education and income. This has its limitations.

THE INEQUALITY-ADJUSTED HUMAN DEVELOPMENT INDEX (IHDI)

This index is a modification of the Human Development Index. It adds a fourth indicator of development: inequality. Each of the three measures of life expectancy, educational achievement and the standard of living are adjusted for degrees of inequality using the Atkinson index, a measure of inequality like the Gini coefficient (see Chapter 33). The greater the inequality in a country, the greater the negative impact on the IHDI score which, like the HDI, goes from 0 (least developed) to 1 (most developed).

OTHER MEASURES OF DEVELOPMENT

It is possible to judge economic development by considering a variety of statistics on their own or, as is more common, in addition to the HDI. The World Bank publishes a wide variety of development indicators. These measures include the percentage of adult male labour in agriculture, access to clean water, energy consumption per capita, access to internet per thousand of population, access to mobile phones per thousand of population and access to doctors per thousand of population.

THE PERCENTAGE OF ADULT MALE LABOUR IN AGRICULTURE

Developing economies tend to have a high proportion of adult males employed in agriculture, whereas advanced economies have a low proportion of adult males employed in agriculture.

- It is normally assumed that as an economy develops, labour will flow from agriculture and other labour intensive primary activities to industry and finally to the services sector. At the same time, workers will migrate from rural to urban areas. It is through industrialisation that an economy can significantly increase its productivity.

- There are fewer workers employed in agriculture in advanced economies because more capital-intensive methods are used. This reduces the demand for labour in this sector.

This indicator can therefore help to identify the stage of development an economy has reached.

ACCESS TO CLEAN WATER

For the poorest economies, economic development will mean a rising share of their population has access to clean water. Improved access to clean water improves health, reduces poverty and will also indirectly improve educational achievement and economic opportunities.

ENERGY CONSUMPTION PER CAPITA

Industrialisation is one important strategy to promote growth and development. Moving resources away from agriculture and into industry means energy use increases. Energy use also increases as the use of motor transport increases. Therefore, this indicator can help identify economies at different stages of development.

Energy use has been growing rapidly in low- and middle-income economies, but high-income countries still use almost five times as much energy per capita.

ACCESS TO INTERNET PER THOUSAND OF THE POPULATION

The proportion of the population using the internet is a good indicator of connectivity of individuals, the government and businesses. The use of the internet offers opportunities for economic growth, improved health and raising the quality of human capital through distance learning.

ACCESS TO MOBILE PHONES PER THOUSAND OF THE POPULATION

The number of mobile phones per thousand of the population is a good indicator of how well individuals and businesses are connected within an economy. Access to mobile phones means an economy has opportunities to advance human and economic development. These range from being able to access health information, making cash payments, stimulating job creation and improving citizens' involvement in the democratic process.

ACCESS TO DOCTORS PER THOUSAND OF THE POPULATION

Economies at low levels of development will have a lower number of medical staff per 1000 of the population. They do not have adequate resources to fund health care to the same extent as more developed economies. The World Health Organization estimates that at least 2.5 medical staff (doctors, nurses and midwives) per 1000 people are needed to provide adequate health care.

USING INDICATORS TO MEASURE ECONOMIC DEVELOPMENT

There is a wide range of possible indicators which can be used to measure development in addition to those discussed in this chapter, for example, CO_2 emissions per capita.

Sometimes collecting only one indicator will provide a quick and fairly accurate measure.

Chapter 40 – Constraints on growth and development

ECONOMIC FACTORS WHICH CONSTRAIN GROWTH AND DEVELOPMENT

There are many factors which explain why countries find it hard to move to higher levels of economic development or which constrain economic growth. Some factors apply particularly to developing countries; other factors can be relevant for both developed and developing countries.

COMMODITIES

Commodities and natural resources should bring prosperity and increased rates of economic development to countries that are abundant in natural resources. However, there are a number of reasons why abundance of natural resources might lead to a **resource curse** where economic development is limited.

VOLATILITY OF COMMODITY PRICES

Fluctuations (changes) in commodity prices will cause problems for countries, particularly those developing countries who rely on commodity exports as a significant source of export revenue. The more price inelastic the demand for the commodity, the greater the changes in price are likely to be. Sudden price changes can mean large amounts of extra revenue being earned by an economy or large falls in revenue. This makes it difficult for firms and governments to predict their revenues in the short and long term, which can discourage investment and make it hard for a government to plan economic development.

PRIMARY PRODUCT DEPENDENCY

When commodity prices are declining, the terms of trade for commodity export dependent countries fall. They can afford to buy fewer goods and services from abroad with the revenues earned from the sale of commodities. The Prebisch-Singer hypothesis suggests that over the long run the prices of commodities will fall compared to all other goods, such as manufactured goods. This suggests that countries with a high export dependency on primary products will experience a continued worsening of their terms of trade.

Another problem is what is known as the **Dutch disease.** Some countries become significant commodity producers in a relatively short space of time. The Netherlands in the 1960s became a significant producer of natural gas. As a result, the Netherlands imported less energy and exported gas. This increased the demand for the Dutch currency and reduced supply, leading to a significant rise in the Dutch foreign exchange rate.

THE SAVINGS GAP, FOREIGN CURRENCY GAP AND CAPITAL FLIGHT

Development economics has a relatively short history. The first major work in this field of economics was done in the 1950s. The most important question which development economists first asked themselves was 'how can economic growth in an economy be raised?' Development economists initially used a widely accepted growth theory of the time called the **Harrod-Domar growth model.**

One way out of this is for rich developed countries to give foreign aid. If this aid is used to boost investment, it can fill the **savings gap,** the difference between actual savings and the level of savings needed to achieve a higher growth rate. Equally, foreign aid might be used to fill a foreign **currency gap.**

Economists widely agree that increasing savings and investment is likely to secure higher growth rates. However, these are not sufficient conditions for economic growth. Investment can be wasted. Building a new steel production facility in a developing country might lead to nothing if workers are not able to run the facility, or if there are no ports to import the materials needed, or no roads to transport the finished product. There can be **capital flight.**

DEMOGRAPHIC FACTORS

The changing structure of the population and its rate of growth can be important for development. In many countries across the world, the population is ageing. This means the proportion of workers to dependents (people who need another person to provide money, food, clothes etc.) is falling. With fewer workers, it will be hard to generate more output in the economy. This limits economic growth and makes development harder.

DEBT

In the 1980s and 1990s, developing countries faced a significant issue of foreign currency debt. Banks encouraged borrowing US dollars at low rates, but the rise in US dollar value and interest rates led to many paying more in local currencies to pay interest on foreign currency loans. The 'Third World debt crisis' resulted in poor developing countries paying more in interest and debt to developed countries than they received in loans and foreign aid. The crisis was resolved through debt reduction, economic growth, and exports, but slowed economic development in affected countries.

ACCESS TO CREDIT AND BANKING

In developed countries, individuals, firms and governments have access to sophisticated financial systems that allow them to save money with interest and to borrow money. Equally, there are systems for buying shares in companies. There are banks, stock markets and insurance companies for example. The poorer the developing country, the less likely it is that individuals and businesses will have access to such financial institutions and markets. For example, the World Bank put the 'credit gap' for small but formal businesses in developing countries at around $1 trillion in 2011. Include informal firms, and the credit gap is even greater.

INFRASTRUCTURE

The built environment is vital for economic development. In developed countries, such as those in the EU, there is a complex network of buildings, roads, railways, airports, ports, utilities such as water and gas pipes, telephone and electricity cables, and industrial plants. The greater the level of development, the

higher tends to be the value of the built environment. Growth in physical capital is as important as growth in human capital if more goods and services are to be produced.

Many developing countries have an infrastructure gap: the amount and quality of infrastructure is too low. This reduces efficiency in the economy and slows economic growth.

EDUCATION AND SKILLS

Developing countries have made great progress in getting children into school. Although the majority of children are now in primary school, there are still some 260 million children in the world not attending primary or secondary school.

THE IMPACT OF NON-ECONOMIC FACTORS

There are many non-economic factors that influence development and economic growth.

CORRUPTION

Individuals and businesses are less willing to buy machinery, build factories or establish brands if powerful individuals or organisations within the state can effectively steal those assets. When government officials 'steal assets', this is corruption - dishonest or fraudulent conduct by those in power, often involving bribery. Where corruption is widespread, it is often better to seek positions where you can receive large amounts of bribes than ones where there is a genuine output of goods and services. In authoritarian regimes, corruption tends to be particularly severe and widespread.

POOR GOVERNANCE

Growth and development are promoted by good governance and the rule of law. Where the rule of law is weak, there is often a lack of property rights; individuals and businesses are unable to use the law to defend their ownership of assets. The result is lower investment and lower output.

Too much bureaucracy and regulation can also be a result of poor governance. In some countries, it is very costly and time-consuming to set up a legal business because of the bureaucracy and regulation involved. Arbitrary application of tax laws can also discourage business activity.

CIVIL WARS

One major cause of negative development is war. Countries such as Syria, Iraq and Afghanistan have paid a very heavy price in recent years for continued war that has destroyed both physical and human capital. The long run aggregate supply curve will shift to the left and the PPF will shift inwards.

MIGRATION

Migration also occurs for non-economic reasons, such as those fleeing dangerous political conditions or war. Migration flows might also change for political reasons rather than economic ones.

TERRORISM

According to the Global Terrorism Index, the cost of terrorism to the world was $52.9 billion in 2014. The ten countries most affected by terrorism saw decreased GDP growth rates of between 0.51 and 0.8 per cent. One impact of terrorism is that it reduces FDI inflows for developing countries. In Nigeria it was estimated that terrorism caused FDI inflows to fall by $6.1 billion in 2010.

OTHER CONSTRAINTS

Diseases such as HIV/AIDS and malaria continue to have a heavy impact on affected countries. Geographical location is also important.

Economic growth in China has been much faster in coastal regions with easier access to ports for exported goods than inland. Landlocked countries such as Bolivia or Uganda have a natural economic disadvantage compared to countries with access to sea routes.

There are also gender issues which constrain economic growth and development for some countries. In many countries, for example, girls complete fewer years of schooling than boys, so they build up less human capital. High mortality rates from childbirth are also a problem faced by women in poorer developing countries

SUBJECT VOCABULARY

capital flight when savings are sent abroad by citizens and firms of a country to another country which is either seen as being more secure or where the money can be hidden from government authorities

demographic dividend economic growth potential that can result from shifts in a population's age structure, mainly when the share of the working-age population (15 to 64) is larger than the non-working-age share of the population (14 and younger, and 65 and older)

Dutch disease in economics, where exploitation of natural resources leads to a rise in the exchange rate and the loss of international competitiveness of the country in the production of non-resource goods and services

foreign currency (exchange) gap the difference between the actual level of exports and the level of exports needed to create higher economic growth for an economy; sometimes called the foreign exchange gap

Harrod–Domar growth model a model which suggests that economic growth is dependent on the saving ratio and technological progress

Prebisch–Singer hypothesis suggests that over the long run, the prices of commodities will fall compared to all other goods, such as manufactured goods; this suggests that countries with a high export dependency on primary products will experience a continued worsening of their terms of trade

resource curse exists where an abundance of natural resources in a country is exploited, but there is consequently little increase in economic development

savings gap in development economics, the difference between the actual level of savings in an economy and the level of savings needed to finance the investment required for a higher rate of economic growth

Chapter 41 – Measure to promote growth and development

DIFFERENT TYPES OF DEVELOPMENT STRATEGY

Economists and politicians have different opinions about the most effective development strategies for any individual country or group of countries. Some economists tend to recommend market-**orientated strategies,** which rely upon free markets to deliver economic development. Other economists tend to advocate **interventionist strategies,** where government plays a leading role, regulating and manipulating markets or bypassing markets through direct provision of goods and services.

MARKET-ORIENTATED STRATEGIES TO PROMOTE GROWTH AND DEVELOPMENT

TRADE LIBERALISATION

Trade liberalisation is the removal or reduction of trade barriers between countries. One objective of trade liberalisation might be to gain from export-led growth. An increase in exports will increase aggregate demand, causing actual growth.

Removing trade barriers will also force domestic industries either to close or to become as efficient as any world producer. This increase in efficiency will promote supply-side growth. Specialisation and trade mean resources will be reallocated to those industries that produce goods in which the country has a comparative advantage in production. There is potential for all countries to gain.

PROMOTION OF FOREIGN DIRECT INVESTMENT (FDI)

Foreign direct investment can help remove some of the constraints on economic growth and development. For example:

• Inflows of FDI add to the resources which can be given over to investment, helping to close any saving gap or foreign currency gap. FDI is the largest source of external finance for many developing countries

• There is often a transfer of knowledge that adds to a country's stock of human and physical capital. As discussed in Chapter 21, greenfield foreign direct investment is likely to have a positive impact on growth for recipient countries.

The Global Investment Competitiveness report of 2017/2018 said FDI is good for development. In 2016, more than 40 per cent of the global $1.75 trillion FDI flows were to developing countries. The report stressed the productivity gains for these countries. The research concluded that a business- friendly regulatory environment and political stability were the top two factors influencing transnational companies' investment decisions in developing countries. Other factors include good infrastructure, access to land and low tax rates. So, to promote FDI, a developing country will have to find ways to offer some of these advantages.

Removal of government subsidies

Subsidies is often regarded as a strategy for promoting development. The reasons for this include:

• Subsidies are poorly targeted if everyone in the population can buy the subsidised goods. If everyone can buy subsidised rice, for example, rich households benefit even though they do not need the subsidies.

• Economic theory suggests that welfare would probably be higher if poor households were given cash payments. The payments could be targeted, avoiding the problem of everyone being able to buy subsidised goods.

• Where subsidies are given to farmers or industry, government is saying that it is better at allocating scarce resources than free markets. This may not be the case.

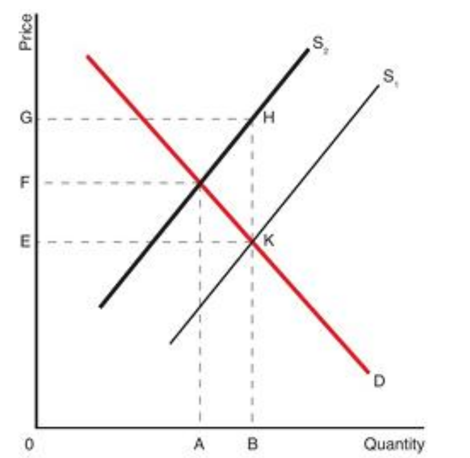
• Subsidies can easily become a significant proportion of total government spending. There is then a large opportunity cost in development terms. The money used for subsidies is not available to spend on education, health care or building infrastructure.

• Subsidies can be a major source of corruption and criminality. For example, in Venezuela, subsidised fuel is smuggled across its borders and sold in neighbouring countries at a higher price. Figure 1 shows the effect on price and quantity of removing a subsidy. With a subsidy of EG per unit, quantity demanded and supplied is OB.

FIGURE 1

Removing a subsidy

Removing a subsidy of EG per unit on a good leads to a rise in equilibrium price of EF and a fall in quantity demanded and supplied of AB.



PRIVATISATION

In the 1960s and 1970s, many developing countries were influenced by socialist and Marxist theories of development. These theories advocated interventionist policies that included state ownership of many key industries.

However, privatisation is recommended by free- market economists. They argue that the discipline of the market forces firms to cut their average costs to a minimum, leading to productive efficiency. They also have to be allocatively efficient, giving customers what they want to buy. In contrast, nationalised industries have no incentive to be efficient.

FLOATING EXCHANGE RATES

Most governments have a choice about which type of exchange rate system (explained in Chapter 29) to use for their currency. The few that do not are countries that are part of a monetary union such as the Eurozone. Some countries use a floating exchange rate system. Market forces determine the value of the currency. The advantage of this is that governments do not have to intervene and do not have to worry about their gold and foreign currency reserves running out. Another advantage is that depreciation, when it occurs in a floating exchange rate system, is likely to cause export-led growth.

DEVELOPING A FINANCIAL SECTOR

Poorer developing countries have relatively weak financial sectors, because the provision of banking services for low-income households and firms with small revenues is unlikely to be profitable and may be deemed too risky. Moreover, many of the borrowers in developing countries lack the necessary collateral to borrow from formal financial institutions.

Microfinance schemes are one way of reaching out to low-income households. These are schemes started by NGOs (non-governmental organisations, some of which are charities), whereby very small loans are given out to individuals who would otherwise not have access to borrowed money in the formal sector. Interest rates are reasonable and often lending is done within the context of a group, like a village.

INTERVENTIONIST STRATEGIES

DEVELOPMENT OF HUMAN CAPITAL

Education and skills have long been recognised as an important factor in economic development. Countries that invested heavily in education when they were still relatively poor, such as China and South Korea, have benefited in the long term. Education raises the human capital of the population and allows workers to be more productive.

PROTECTIONISM

At times, countries might believe that their own development could best be promoted through a policy of import substitution, the deliberate attempt to replace imported goods with domestically produced goods by adopting protectionist measures.

In 2018, protectionism was more widely used by some countries as a means of promoting economic growth and development. Examples include:

- The USA introduced steel tariffs as a means of protecting its steel industry. The likely objective was to protect US jobs and so, at least in the short run, promote economic growth.
- In January 2018 the Indian government announced that it planned to introduce 70 per cent tariffs on solar panels imported from several countries, but mostly directed at China. India's panel makers would benefit from these tariffs. The objective was to promote domestic manufacturing in India as part of the 'Make in India' scheme. As discussed later in this chapter, promoting manufacturing (industrialisation) is often used as a strategy to promote economic growth and development in an economy.

However, criticisms include:

• Long run, output and growth of output will be lower than they would otherwise have been, because import substitution denies the country the benefits to be gained from specialisation.

• Protectionism leads to dynamic inefficiency.

small countries. The larger the country, the more opportunities there are for specialisation within the country.

MANAGED EXCHANGE RATES

A managed exchange rate is an interventionist strategy. Governments can choose to manage a single exchange rate, buying and selling currency to fix an exchange rate.

• A high value exchange reduces the cost of imports. This is beneficial for growth if it encourages more imports of capital goods (investment goods).

• A low value exchange rate increases price competitiveness in foreign markets and leads to export-led growth.

However, speculation in currency markets is so large that countries find it very difficult to maintain an exchange rate even within a broad band over a number of years.

One of the most interventionist types of policy is to fix a number of different exchange rates.

• A high exchange rate for imports of essential products means that the domestic price of these goods is low. This helps reduce poverty if they are essential consumer goods. It encourages investment if they are investment goods.

• A lower exchange rate for other imports means that the domestic price of these goods is higher, discouraging their import. So less scarce foreign exchange is likely to be used for non-essential imports than if the exchange rate was free floating.

• A very low exchange rate for exports means that exports are price competitive in foreign markets. An added advantage of fixing exchange rates in this way is that there is exchange rate stability. Exporters and importers can plan for the future.

INFRASTRUCTURE DEVELOPMENT

Infrastructure is essential for economic development. For example, a coastal country needs well-functioning ports if it is to export and import efficiently. A land- locked country needs good roads, railways and airports for trade and the movement of people. Schools and hospitals need to be built.

A government may also choose to spend more money on infrastructure as a means of achieving faster economic growth.

PROMOTING JOINT VENTURES WITH TNCS

FDI can be associated with exploitation where foreign companies take far more from their investment than the country receives in benefits. One way of reducing perceived exploitation is for a government to insist on major investment being set up as a joint venture.

BUFFER STOCK SCHEMES

The price of commodities is volatile over time. This is a problem for developing countries that rely upon commodities for exports, jobs and government income. One way of stabilising commodity prices is to set up a buffer stock scheme. This is likely to be set up by a group of governments to fix world prices for a commodity. Equally, it could operate within a country assuming that exports and imports are controlled.

A buffer stock scheme that works effectively over a long period of time has a number of possible advantages.

- By stabilising prices, it encourages firms in the industry to invest. If it is an agricultural commodity such as rice, it gives farmers an incentive to plan for the long term.
- It prevents sharp falls in prices. If it is an agricultural commodity, it could prevent the poorest farmers sinking into absolute poverty.
- Consumers will also benefit from less price volatility. Buffer stock schemes combine elements of both minimum and maximum prices. Typically a minimum

So the buffer stock agency has to sell EF. This increases supply by EF and brings the price down to ON, the maximum price.

Buffer stock schemes are not common.

• A considerable amount of capital is needed to set them up. Money is required to buy produce when prices are too low. There are also the costs of administration, transport and storage of produce purchased. If the commodity is a food commodity, it may deteriorate in storage, adding to costs.

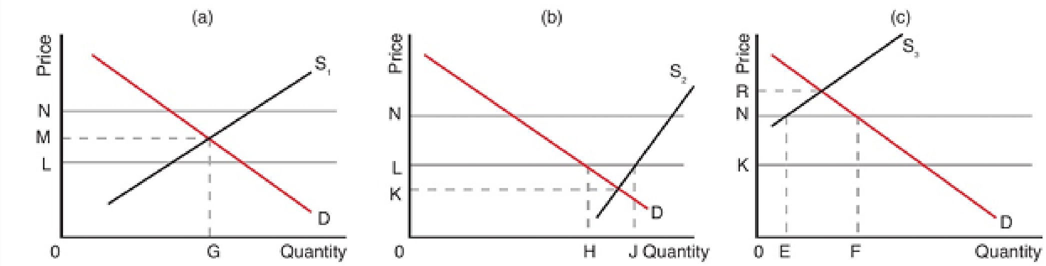
• Those funding the buffer stock scheme must feel that it is benefiting them substantially because others may also benefit without incurring any of the costs.

• The main reason buffer stock schemes are not common, however, is because minimum prices tend to be set too high. In the short term, this benefits producers because they get higher prices than the free market price. In the long term, it is unsustainable.

FIGURE 2

Buffer stock scheme

In (a), the maximum (ON) and minimum (OL) prices set by the buffer scheme are shown. The free market price of OM is between these limits and so there is no intervention. In (b), the free market price of OK is below the minimum price. So the buffer stock scheme has to increase demand by buying HJ to raise the price to OL. In (c), the free market price is above the maximum price. So the buffer stock scheme has to increase supply by selling EF to lower the price to ON.



THE IMPACT OF OTHER STRATEGIES

INDUSTRIALISATION (THE LEWIS STRUCTURAL DUAL-SECTOR MODEL)

Developed countries have large service industries and very small agricultural sectors measured in terms of output and employment. To achieve this, they went through a stage where there was a rapid expansion of manufacturing industry before this shrank in relative importance. Industrialisation is therefore a key feature of economic development of mainly agricultural economies.

However, there are many problems with the Lewis model:

- If a government builds steel plants and car manufacturing facilities, will this cause economic development to happen? In most countries forced industrialisation has tended to lead to a waste of scarce resources because these industries have failed.
- There has been a steady drift of people from rural areas into cities throughout the developing world. However, marginal workers in cities can often have as low incomes and be as underemployed as marginal workers in the countryside.

DEVELOPMENT OF TOURISM

Developing countries are increasing their exports of services over time. One example is tourism.

Tourism has a number of advantages for developing countries compared to, say, manufacturing:

• Demand is income elastic, so as GDP rises in other countries, the demand for tourism services in the developing country should rise by a greater proportion.

• It is labour intensive and therefore creates a large number of jobs in relation to capital employed. Many jobs do not require much education or training and so are accessible particularly to the poor. Jobs are particularly available to women and young people who might otherwise find it hard to get a job.

• Promoting tourism should improve the current account of the balance of payments: credits on the balance of trade in services will increase. This will provide vital foreign exchange earnings and help fill the foreign currency gap.

DEVELOPMENT OF PRIMARY INDUSTRIES

Countries such as Saudi Arabia, Chile, Australia and Norway have seen significant economic development because they have a comparative advantage in production of certain primary commodities. Oil, copper, coal and iron ore have created income and employment. For example, Zambia is Africa's second biggest copper producer. The sector was a key driver of Zambia's economy and helped it achieve one of the world's fastest economic growth rates between 2005 and 2015. China accounts for more than 40 per cent of the metal's global consumption. So rapid economic growth in China is important for Zambia: it keeps copper export volumes as well as copper prices high.

However, as explained in Chapter 40, commodities can be highly damaging to an economy as well as highly advantageous.

DEBT RELIEF (DEBT FORGIVENESS)

Those arguing in favour of debt relief put forward a number of arguments.

• The debt was relatively small for the countries and agencies that were owed the money.

• Debt relief helps to reduce absolute poverty with more resources available to governments to improve living standards.

• Debt relief reduces the foreign currency gap so there is more currency available to import capital goods. This promotes growth.

• Interest payments on the debt had already exceeded the value of the original debt and therefore it was unfair to make poor countries pay more.

• The governments that had originally taken on the debt were often either foolish or corrupt and had been pressured or persuaded into taking on the debt in the first place. Why should poor people today still be paying for the mistakes of a government in power 25 years ago?

However, there were some who argued against debt forgiveness.

• It created a dangerous example for future decision- makers. There was a moral hazard in debt forgiveness because every poor country would in future expect to receive debt relief on loans taken out today. This would cause irresponsible borrowing in the future too.

• Debt relief reduced pressure on weak governments to adopt good and appropriate economic policies. Today, governments of a small number of developing countries find themselves in the same situation as the highly indebted countries of the early 2000s.

FOREIGN AID

Commercial loans are one way of financing development. Foreign aid is another. Foreign aid can take a variety of forms.

Grants The most generous form of aid is a grant. A donor country might, for instance, give a sum of money to a developing country for a development project or it might offer free technical expertise. Humanitarian aid for natural disasters such as earthquakes and famine is another example of grant aid.

Loans Aid might take the form of a loan. The loan might be at commercial rates of interest, in which case the donor country is giving little, if anything, to the developing country borrower. Or it might be a soft loan, a loan which carries a lower rate of interest than the commercial rate of interest.

Tied aid- Aid with conditions attached. For example, Chinese loans to the Sri Lankan government to build the Hambanthota port came with conditions - the construction firm was to be Chinese and some Chinese workers were to be employed

Bilateral aid is given directly from one country to another. A loan from China to Kenya would be an example.

Multilateral aid describes the situation when donor countries give money to an international agency, such as UNICEF (the United Nations Children's Fund), and the agency then disperses the aid. Most bilateral aid is tied in one form or another while multilateral aid is generally not tied.

Reasons why aid can help growth and development include:

• Foreign aid can help to reduce absolute poverty. For example, aid spent on new health clinics will help to ensure basic needs are met.

• Foreign aid can help to fill a savings gap. This should increase investment, setting off positive multiplier effects.

• Foreign aid can help fill a foreign exchange gap. This may help finance more imports of capital goods or it can be used to pay interest on debt owed to foreign investors.

Foreign aid has undoubtedly helped millions of people in developed countries to achieve a better standard of living. However, foreign aid has been increasingly criticised by those in both developed and developing countries.

• It is assumed in the economic argument presented above that governments of developing countries want to maximise the economic welfare of their citizens.

• Aid may not reach those intended, perhaps due to corruption in the government.

• It can be difficult for Western aid agencies to know what sorts of projects will best promotedevelopment for a country.

• Tied foreign aid, especially in the form of loans, may result in developing countries getting a worse 'buy' than if they shopped around internationally for the cheapest product.

• Loans need to be repaid with interest. The repayment of loans has resulted in enormous problems for developing countries, both in the past and today.

• Aid may promote a dependency culture, so governments do not actively improve their own policies to promote growth and development.

THE ROLE OF INTERNATIONAL FINANCIAL INSTITUTIONS AND NON-GOVERNMENT ORGANISATIONS

International financial institutions have a variety of roles to play in development.

THE INTERNATIONAL MONETARY FUND (IMF)

The IMF was one of a group of institutions founded in 1945 to promote world development and stability. Its specific purpose is to 'promote international monetary co-operation, exchange rate stability, and orderly exchange rate arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment' (IMF). It was not founded to promote economic development.

THE WORLD BANK

The World Bank was founded, like the IMF, after the Second World War. Unlike the IMF, it was set up to promote economic development. It is made up of two institutions. The International Bank for Reconstruction and Development (IBRD) focuses on middle income and poor countries considered able to repay debts. The International Development Association (IDA) focuses on the poorest countries in the world. The World Bank 'provides low-interest loans, interest- free credit and grants to developing countries for education, health, infrastructure, communications and many other purposes.

NON-GOVERNMENTAL ORGANISATIONS (NGOS)

NGOs are, as the name implies, organisations which are separate from government and are not commercial, profit-making organisations. There is a wide range of NGOs from local community action groups to charities to pressure groups.

SUBJECT VOCABULARY

bilateral aid when aid is given directly by one country to another

buffer stock scheme a scheme whereby an organisation buys and sells in the open market so as to maintain minimum and maximum prices in the market for a product

industrialisation when an economy moves from one where output and employment are dominated by agriculture to one where manufacturing has a much higher share

interventionist strategies strategies where government plays a leading role, regulating and manipulating markets or bypassing markets through direct provision of goods and services

joint venture a company that is owned by, usually, two major firms or a firm and a government

market-orientated strategies strategies which rely upon free markets to deliver economic development

microfinance schemes when very small loans are given out to individuals, by non-governmental organisations, who would otherwise not have access to borrowed money

multilateral aid when donor countries give money to an international agency, and the agency then disperses the aid

tied aid offering aid on the condition that it is used to buy goods or services from the provider of the aid

trade liberalisation the move towards greater free trade through the removal of protectionist barriers to trade