Economics Higher Level – Section 4: Development Economics

Unit 4.1: Sources of Economic Growth and/or Development

Economic Development – a sustainable improvement in living standards that implies

- Increased per capita income
- Reduced income inequalities
- Better education
- Better health and employment opportunities
- Environmental protection

Increased quantity of resources refers to the physical increase in the amount of land, labor and capital

Increased quality of resources refers to enabling the same quantity of resources to produce more output, achieved through increases in productivity due to technological advances, development of human capital and entrepreneurship

Natural factors – quantity and/or quality of land or raw materials such as mineral deposits, fuel, soil fertility and favorable climate, e.g. OPEC and oil in the 1970s, though not a sufficient—or even necessary—condition for growth, e.g. Ghana, Kenya and Singapore, ROK and Taiwan

Human factors – quantity and/or quality of human capital such as the workforce, increases in productivity or population of workforce shifts the PPC outwards, though many suffer lack of complementary factors of production thus leading to lagging capital growth and causing LDMR to set in

Physical factors – quantity and/or quality of physical capital such as tools, equipment and factories

Institutional factors – set of rules and laws, norms and conventions e.g. legal framework, property rights and stable systems

Common characteristics of LEDCs

- Low per capita GDP
- Low standard of loving
- Poverty
- High rates of population growth
- Large urban informal sector
- Low productivity
- High un- and underemployment
- Dependence on agricultural sector
- Imperfect markets
- Poor systems and infrastructure
- Inappropriate taxation structure
- Dependence and vulnerability in diplomacy

The Poverty Cycle

International Development Goals

- Eradicate extreme poverty and hunger
- Achieve universal primary education
- Gender equality
- Reduce child mortality
- Improve material health
- Combat HIV/AIDS, malaria and other diseases
- Ensure environmental sustainability
- Develop global partnerships for development

Unit 4.2: Measuring Development

GDP – market value of all final goods and services produced over some period of time, usually a year, by productive factors that are located within the geographical boundaries of the country before provision for capital consumption

GNI – market value of all final goods and services produced over some period of time, usually a year, by productive factors owned by residents of the country before provision for capital consumption

Health indicators

- Infant mortality
- Life expectancy at birth
- Maternal mortality

Education indicators

- Adult literacy rate
- Primary school enrolment
- Secondary school enrolment
- Primary school pupil to teacher ratio

HDI Indicators

- Life expectancy at birth
- Mean and expected years of schooling
- Per capita GNI

Disadvantages – no information on income distribution, malnutrition, gender inequalities and demographic trends

Unit 4.3: The Role of Domestic Factors

Education – increasing knowledge and skills is an investment in human capital and enables the workforce in an economy to use skills to develop new ideas or import them from abroad

Health – a developing requires a proper healthcare system, but such a huge merit good would need to be subsidized therefore giving rise to the need for a large tax base

Usage of appropriate technology – technology that is suitable for use with existing factor endowments, both for consumption and in production

Access to credit and micro-credit – lack of inefficiency of banks prevent the ability of people to get loans and hinders growth and development; microcredit is the use of very small loans designed to spur entrepreneurship

Empowerment of women – financial and educational empowerment develops not only themselves but also their society

Income distribution – improvement in income distribution leads to increase in demand for locally produced goods and services, which encourages production and promotes local employment and investment—increasing AD in the short-run and output

Sustainable development – increase in production and consumption to meet the needs of the present generation without compromising the needs of the future generation

Infrastructure – essential facilities and services that are necessary for economic activity to take place, e.g. roads, railways, public utilities, services and telecommunication systems

Unit 4.4: The Role of International Trade

Trade problems in LEDCs

- **Over-specialization in a narrow range of products**, usually primary products with low value-add (the value of a good that is added in each step of a production process)
- **Price volatility of primary products** which work with the inelastic PED for primary products to pose problems for LEDCs
- **Inability to access international markets** as developed countries impose higher tariffs from developing countries than on imports from each other due to protectionism while developing countries impose higher tariffs in imports from each other
- **Long term changes in TOT** – e.g. countries specializing in the export of non-oil commodities have been seeing a deterioration of their TOT, meaning that they can buy fewer imports for the same amount of exports—reasons include low YED and PED for primary products and protection of agriculture and technological advances in agriculture in developed countries.

Result of deteriorating TOT on LEDCs – countries will have to keep increasing exports to maintain a constant level of imports—constantly increasing opportunity cost and therefore more resource will be transferred to the production of exports, increasing the difficulty of achieving diversification of the economy; furthermore, falling export income could lead to a BOT deficit and BOP problem, resulting in borrowing and debt traps; lastly, falling export income could harm rural incomes and increases poverty, affecting tax revenue and thus ability to spend

Trade strategies for growth and development

- **Import substitution** – deliberate effort to replace major imports by encouraging domestic industries through use of protectionist measures
- **Export led growth** – relies on increasing exports through international trade, accompanied by a reduction in protectionism and greater openness
- **Trade liberalization** – removal or reduction of trade barriers that block the free trade of goods and services between countries
- **Trading blocs** – see unit 3.5
- **Diversification** – moving from the production and export of primary products to manufactured and semi-manufactured products

Unit 4.5: The Role of FDI

Foreign Direct Investment – long term fixed capital investment by MNCs or local companies in countries overseas, e.g. remitting funds or buying existing foreign enterprises

MNCs or transnational companies – firms that undertake foreign direct investment and operates in more than one country, running business operations in both home and host countries—they take their operations overseas as:

- Costs of labor is lower
- The countries may be rich in natural resources
- Some developing countries represent huge growing markets
- Government regulations are still lacking in many developing countries

Benefits to MNCs	Benefits to the host nation
• Lower cost of production especially for labor intensive industries • Direct access/proximity to a huge market • Tax holiday schemes, lower regulations or weak labor laws • Bypassing protective measures	• Greater employment and economic activity • Increase in corporate and income tax revenue • Improvement of critical infrastructure • Fills saving gaps of LEDCs • Contributes to foreign currency earnings • Brings in knowledge and expertise which can be transferred to local companies • Creates demand for a variety of services and semi-finished products • May provide greater choice and lower prices to consumers

However, MNCs may stifle competition through exclusivity agreements with host governments and fail to reinvest profits or even deprive domestic firm of talents through hiring the best

Unit 4.6: The Role of Foreign Aid and Multilateral Development Assistance

Foreign aid – the help a country receives from the government of a donor country, through development assistance (economic development through long-term **grants, loans, tied aid, project aid, technical assistance aid and commodity aid**) and humanitarian aid (alleviating poverty and other suffering, through **emergency, medical or food aid**)

NGOs – organization that is not part of a government and was not founded by states—therefore typically independent of governments

IMF – an organization of 184 countries working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth and reduce poverty

World Bank – collection of 5 individual organizations to promote economic development

Unit 4.7: The Role of International Debt

Foreign debt – a nation's level of external debt—total amount of public and private debt incurred by borrowing from foreign creditors

Debt crisis – occurs when the level of debt in developing countries exceeds their ability to pay

Reasons for borrowing from abroad

- Underdeveloped domestic financial markets
- Abundance of loanable funds in international financial markets
- Foreign exchange needed to finance import purchases as well as a source of investment funds
- To service existing debts, worsening BOP

Consequences

- BOP problems
- Debt trap
- Opportunity costs and lower public investment
- Lower private investment
- Lower economic growth and development

Debt rescheduling – new loans on better terms, longer repayment period and lower rates

IMF lending and stabilization policies – conditional loans from the IMF for country to pursue stabilization policies

World Bank lending and structural adjustment loans – conditional loans, forcing the government to pursue economic and trade liberalization

Debt cancellation – funds can be transferred to development and overcomes heavy debt, but risks moral hazard and rewards irresponsible governments

Unit 4.8: The Balance between Markets and Intervention

Market-oriented policies – designed to minimize the role of government intervention and maximize the free operations of demand and supply in the market

Interventionist policies – involves an active role by the government and manipulation of the workings of the markets in the economy

Benefits of market-oriented policies	Detriments of market-oriented policies
• More efficient allocation of resources • Economic growth • Reduced budget deficits	• Market failure • Income inequalities • Development of a dual economy

Benefits of interventionist policies	Detriments of interventionist policies
• Provision of infrastructure • Investment in human capital • Provision of a stable macroeconomic economy • Provision of a social safety net	• Excessive bureaucracy • Poor planning and corruption