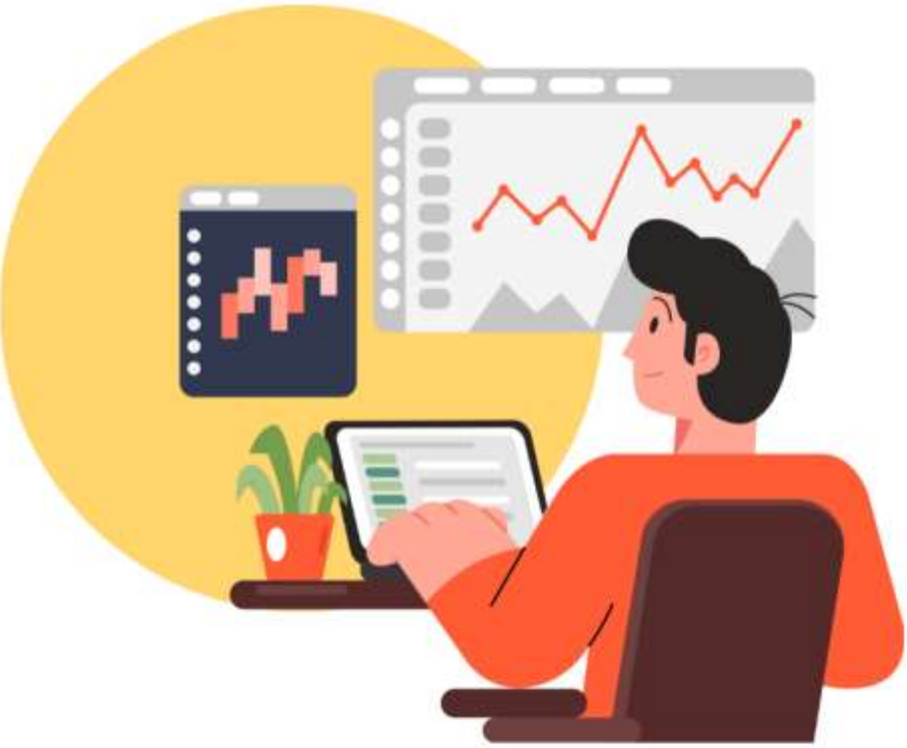
Topics in Economic Development



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THE ROLE OF DOMESTIC FACTORS

Education And Health

- Education and health are believed to be fundamental human rights. They are important in expanding freedoms.
- A person is more likely to live a longer and healthier life if they are literate, get enough food, are healthy, and have access to clean water and other health services.
- Education and health services are merit goods with positive consumption externalities.
    - Economic growth benefits from education
    - Education contributes to capital improvement.
    - Education lowers unemployment and increases political stability.
    - Education has social benefits (low crime).
    - Women education promotes increased women population in the labor force, lower birth rates, and reduction of poverty.
    - Education benefits spill-over to health: improvements in maternal health, basic hygiene, etc.
    - Health leads to greater productivity.
    - Healthy people lower risk of spreading diseases.
    - Immunization benefits a community.
    - Health benefits spill-over to education: longer lifespan, longer times in school, etc.
- East Asian countries have invested more in education, which helped growth.
- According to the World Bank, the type of education with the greatest contribution is elementary education, but many developing countries invest too much in higher education.
    - Brain drain can occur, and graduates will move to developed countries.
    - Internal brain drain can also occur when highly educated people have to find other types of unrelated employment – this causes misallocation.
- Appropriate government intervention in health and education include subsidies and direct gov't provision. Investments in health, such as clean water and sanitation are also important. Legislation can

make education compulsory and advertising can convince people of education/health benefits.

Appropriate Technology

- Appropriate technology is technology suited to a certain economic, geographic, ecological, and climate condition.
- In developing countries, there is often a large quantity of labor, but physical capital is hard to get. In developed countries, labor is scarce and physical capital is abundant. There's also a larger capacity to produce and maintain advanced tech.
- Developing and developed countries have different needs.
- Labor-intensive technologies use more labor compared to capital. Results in increase in local employment and use of local skills.
- Capital-using technologies use more capital compared to labor. Can increase unemployment and displace workers in developing countries.
- Developing countries have tried to make inappropriate technology that is capital- intensive, such as the push for industrialization. This contributed to unemployment and growth of the informal sector.
- Due to their climate and ecological conditions, technologies developed in developed nations may not be suitable for developing nations.
- Developing countries have fewer resources to devote to R&D, but developed countries spend more.
  The private sector is responsible for a lot of R&D spending, but in developing countries the contribution is a lot lower.

Banking, Credit, And Micro-Credit

- Access to credit and banking are crucial to development and growth. They connect savers and investors, making saved money accessible to borrowers..
  - Provide incentive for people to save (interest)
    Credit should be made available to farmers and businesses so that they can grow.
  - Provide consumers with credit for human capital investments
    Access to credit for poverty alleviation

- Commercial banking systems in developing countries are not developed. High public sector ownership, which usually leads to lower efficiency.
- Banks in developing countries usually cater to richer borrowers because they are usually branches of other banks that provide loans to firms.
- Most people then have to rely on loan sharks (high interest rates), or pawnbrokers.
  Micro-credit – small loans to people w/o access to credit and are delivered through
- microfinance institutions such as credit unions or non-governmental organizations.
- MFIs lend to many borrowers, such as small enterprises and people in the informal sector, or displaced persons.
  Micro-credit can have a positive impact on poverty reduction, but reach only a small proportion of poor people.
- Micro-credit is still controversial:
    - It's possible that microcredit programs will take the place of necessary government policies to fight poverty.
    - Microfinancing alone cannot alleviate poverty; it is not an alternative.
    - Micro-credit schemes contribute to the growth of the informal sector.
    - Some poor and unskilled people may be harmed by micro-credit because they still cannot repay these loans.
    - Interest rates in micro-credit schemes are too high.

The Empowerment Of Women

- Countries face gender inequalities, especially discrimination against women and girls.
- Empowerment – elimination of deprivations and creating equality of opportunities. Improves well-being and has spillover benefits.
- Women and girls have higher mortality rates in developing countries, which lower the ratio of women to men.
- Ratio of women: men is greater than 1.05 in the UK and US, but lower than 1 in developing countries. This is because girls are often neglected during childhood, and boys are treated better.

- Some cultures focus on a boy’s education because girls aren’t intended to seek work.
- Lower education/skills mean that women have fewer qualifications to take on jobs, and women often face discrimination.
- Women work more in the informal sector and don’t receive formal sector benefits.
- Women have more unpaid responsibilities.
- Some countries that are less developed have laws that state that property rights are passed to men, so some gain less land.
- Due to discrimination and lack of property rights, they have nothing that can be used as collateral for obtaining credit.
- Women’s incomes are usually lower than men’s, and make women the poorest among developing countries.
- Female-headed households are poorer because there is no man earning an income and women have lower earning potential.
- Women’s empowerment has positive externalities
    - Improvements in child health and decrease in child mortality
    - Improvements in child education
    - Quality of human resources
    - Lower fertility

Income Distribution

- Economists used to believe that high income inequality was necessary for growth.
- Today, economists say that unequal distribution will act as a barrier to growth and development.
    - High inequality lead to overall savings (rich people buy stuff instead of save)
    - Government spending on merit goods can improve income distribution and lead to growth/development
    - Poor cannot obtain credit with unequal distribution, and thus lower development
    - Improved income distribution increases local demand and local production

- Concentration of income in a few hands means that they have the ability to influence policies
  More equal distribution leads to greater political stability

Infrastructure

- Infrastructure – public utilities, roads, canals, transport places; physical capital that comes from investments and represents ~20% of developing countries' investments.
- Government responsible for providing infrastructure, because there may be monopolies if it were in private hands.
- Infrastructure increases productivity and lowers production costs.
- Infrastructure allows modernization and diversification of the economy. It provides services important for a standard of living.
- With available water supplies, some women don't have to spend a large portion of their time carrying water.
- Safe energy sources results in less air pollution and affects health of people. Irrigation increases yields.
- Though there is evidence that infrastructure can help increase economic development and growth, countries do not perform it well, because:
    - there are financing issues
    - there is inadequate maintenance and lack of revenues result in low quality services
    - due to lack of revenue, many people aren't able to access it
    - there is misallocation of resources and the environment is neglected.

THE ROLE OF INTERNATIONAL TRADE BARRIERS

- For international trade to be considered as an engine for growth and an engine for development, it must achieve these objectives:
    - increased rates of economic growth based on production of goods to foreign markets

- increased incomes through improved employment opportunities
- increased export earnings that can finance key inputs such as appropriate capital goods
- diversification of domestic production and export

Over-Specialization On Narrow Range Of Products: Missing Benefits Of Diversification

- Low-income developing nations tend to concentrate on exporting a small number of primary commodities. As a nation expands, the primary commodities sector shrinks.
- If a country specializes in something, they often export that same type of thing. Diversification means that a country can vary its exports. Developing countries heavily rely on the export of primary products.
- The concept of value added refers to the value of a good that is added in each production step. A cocoa-bean producing company can produce chocolate too, which adds value and diversifies the country into chocolate manufacturing.
- Adding value can:
    - allow engagement in more varied production
    - make employment opportunities
    - establish new firms
    - expand into high tech activities
- Countries that produce primary commodities and export them in the raw form will miss those benefits.

Price Volatility

- Primary products tend to have low PEDs and PESs, which means that the change in prices can cause a lot of consequences. Price fluctuation will also cause farmers' incomes and investment to fluctuate. Exporting primary products will mean that exports can fluctuate too.

Inability To Access International Markets

- Developed countries have higher tariffs on imports from developing countries than on imports from each other.This prevents developing nations from expanding into markets with greater wealth.
- Developed countries use tariff barriers to discourage the development of manufacturing and diversification into higher value-added activities. They have low tariffs on raw materials but higher tariffs on processed goods. Known as tariff escalation, this makes it harder for developing nations to enter the manufacturing sector.
- Developing countries impose high tariff barriers on trade with each other. Tariff barriers between developing countries can be higher than those by developed countries.
- Agriculture is a protected sector of developed countries, because farmers earn low incomes and need assistance. However, the larger farmers gain the most benefit. This makes it hard for developing countries to export. Developed countries have support systems such as the EU's CAP with price floors and subsidies.
- The EU's Common Agricultural Policy sets a price floor, and the surplus is purchased by the EU (stored or exported).
- The US farm policy uses price supports and export subsidies.
- The policies of farm support have an effect on developing nations
    - Global misallocation of resources and inefficiency
    - Low export earnings for developing countries
    - Increased poverty among farmers
- Certain non-tariff barriers have begun to increase, such as administrative barriers and standards. These "new trade protection" methods are concerns because they may be used to limit imports.

TRADE STRATEGIES FOR ECONOMIC GROWTH & DEVELOPMENT

- Import substitution is a growth and trade strategy in which a nation uses trade protection to stop imports and produces basic goods to boost domestic industry.
    - Independence seen as a way to modernize

- The majority of developed nations started with some import substitution strategies.
- Countries that are pessimistic about their growth's reliance on exports because of primary commodities
- Saving on use of foreign exchange to buy imports will rise, since imports are reduced.
- Infant industries need barriers to protect them against competition.

- Import substitution policies have consequences:
    - High levels of protection, causing inefficiency and resource misallocation. Consumers have to pay high prices.
    - Exchange rates that are overvalued made export prices go down and import prices go up. This implies that modest capital imports would bring about improper innovation and make horticultural products more costly
    - Rely on a lot of industrial policies (interventionist) and government intervention
    - Increased need for food imports due to neglect of agriculture
    - Increased need for capital and food imports
    - Encouraging capital-intensive methods, instead of labor-intensive methods
    - Negative employment and income distribution
    - Limited long term growth possibility
    - More corruption
- Export promotion – growth and trade strategy where a country expands exports, like the Asian Tigers
    - State ownership of financial institutions
    - Targeting of specific export industries (that used higher skill levels)
    - Industrial policies that support export industries
    - Some domestic industry protection
    - Multinational corporation requirements to maximize FDI
    - Large public investments.
    - Incentives for private sector R&D.
- Export promotion is more successful because:
    - Expansion into foreign markets
    - Diversification benefits

- Major human capital investments and appropriate technologies
    - Increased employments and export earnings avoided BoP difficulties
- Trade liberalization – elimination of trade barriers.
- Free market approach to growth and development known as the Washington Consensus because it was shared by agencies based in Washington, DC.
    - trade and interest rate liberalization
    - freely floating exchange rates
    - privatization and deregulation
    - lifting FDI restrictions and limiting government borrowing
    - maintaining some health, education, and infrastructure based gov't spending.
- Numerous nations have gradually increased their liberalization. Countries realized that some benefits had not been achieved by the 1990s.
    - Liberalization has limited export growth and diversification benefits. Probably due to trade protection policies used by other countries.
    - Liberalization has limited economic growth effects. No real links between open trade policies and economic growth.
    - Liberalization increased income inequalities and poverty in developing countries.
- Those in the formal sector benefit, but some become less educated, cannot get credit, become unemployed, some switch to commodities, etc. However, it is argued that gains > losses.
- According to Joseph Stiglitz's New Development Consensus, trade liberalization is important, but the government still needs to intervene in areas like education and health, avoiding deficits, income distribution effects, and supporting economic development, among other things.
- Government intervention is important to create conditions needed for markets and free trade.

The World Trade Organization

- **The WTO has benefits:**
  - Encourages smooth trade flows and resolves disputes to keep the peace
  - Helps settle disputes constructively
  - Decisions made by consensus
  - WTO results in lower trade barriers
  - Lower barriers increase international trade.
  - More international trade results in greater range of goods
  - Trade leads to increased growth and employment.
  - Trade allows some specialization and efficient resource use
  - Governments can represent broader interest
  - WTO encourages good governments

- The Uruguay Round reduced tariffs by around 33% on average and provided IP
  protection and slow elimination of some quotas.
  - Developed countries had greater tariff reductions than developing ones
  - Textile tariffs still higher for developing countries
  - Tariff escalation
  - Developed countries use non-tariff borders
  - Agricultural subsidies of developed countries are not reduced.
  - Technology costs rise for developing nations as a result of IP protection.
  - MNCs don’t have to buy supplies locally.

- WTO initiated the Millennium Round in 1999 but anti-globalization demonstrations took place. After another Doha Round, it was realized that the developed countries dominated negotiations
- Preferential trade agreements slow WTO made progress and developing countries can use blocs to bypass some obstacles
- FTAs can help developing countries achieve growth when they are regional and have a geographical closeness along with similar market sizes.

- Bilateral FTAs are usually between developing and developed countries – and can provide the developing country with developed country market access, but:
    - developing country must have equal tariff cuts, greater than WTO regulations
    - FTAs between developing nations and developed nations will reduce advantage.
    - Deficits can be caused by more imports and less exports.
    - Developing countries at disadvantage with weaker bargaining power

- The reallocation of resources into new activities to increase the range of g/s made is referred to as diversification.
- Sustained exports increase
- Development of tech capabilities and skills
- Reduced vulnerability to fluctuations Use of domestic primary commodities
- The free movement of financial
- capital within and outside of a country as a result of the removal of exchange controls is referred to as capital liberalization.Non-convertible currencies have exchange controls.
- Non-convertibility avoids capital flight, currency speculation, and assists in conducting monetary policy. Full convertibility allows access to foreign capital, FDI, and competition between financial institutions
- To adopt convertibility, there must be a stable political system and economic policy,sound monetary/fiscal policies, and strong financial institutions.

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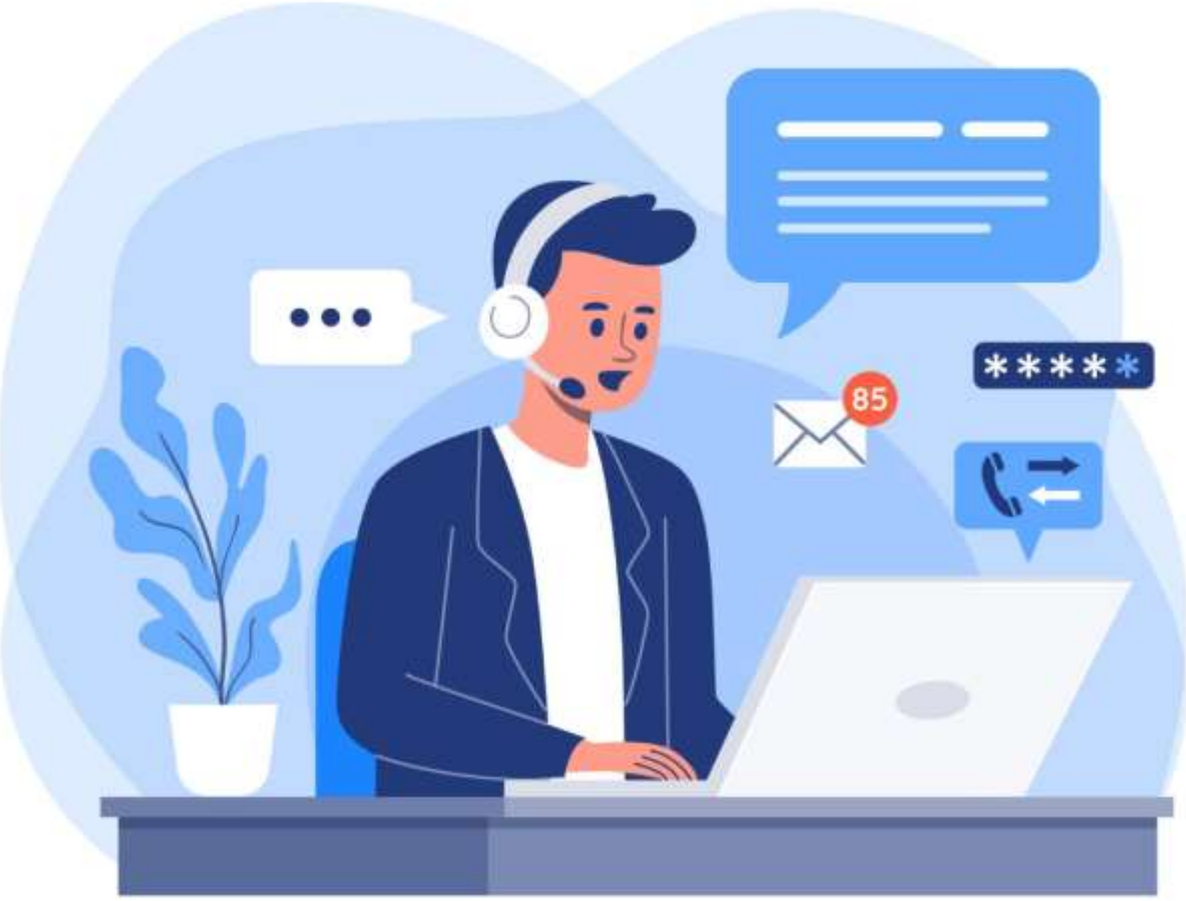

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