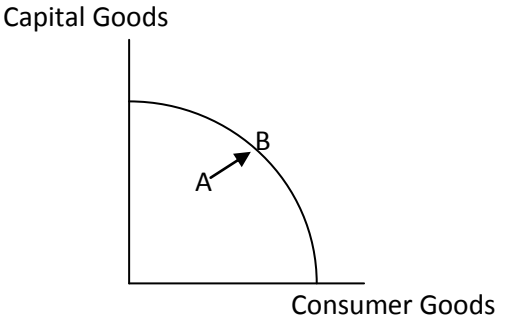
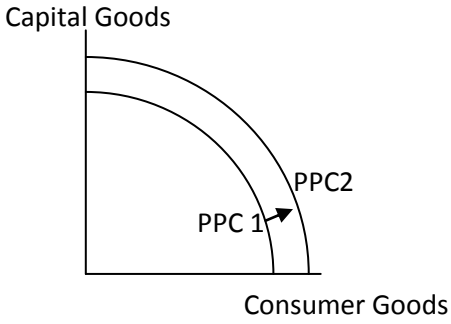
ED1 Introduction to Economic Growth and Development

Economic growth is an important goal of governments in both the developed and the developing world. It is a simple quantitative idea, being simply an increase in the real output of an economy over time, measured as an increase in real GDP.

We can show economic growth occurring a couple of ways using production possibility curves:





In the diagram at left, a reduction in unemployment or an increase in productive efficiency has led to an increase in output as the actual output moves closer to potential output. In less-developed countries, this often results from adopting appropriate technology or changing institutions and regulations to encourage economic participation. All countries, though, can achieve higher economic growth through making productivity improvements, often through enacting supply-side reforms.

The diagram at right, meanwhile, shows an increase in potential output due to an increase in the quantity or quality of the economy's productive resources. All countries' economic growth depends upon making investments in either physical capital (ie machinery and technology), human capital (education and skills development) or natural capital (developing farms and mines) now in order to enjoy higher incomes later. Often, while developing countries have ample natural and human resources, they are held back by a shortage of capital. Policies designed to encourage foreign (and domestic) companies and entrepreneurs to invest in and establish productive enterprises can be very successful so long as the entrepreneurs have confidence that their capital will be safe.

Economic growth can also be shown by a rightward shift in the long-run aggregate supply curve (LRAS), which denotes the same set of circumstances as the PPC on the right. If a country increases either the quantity or quality of its productive resources, its potential output has risen.

Economic growth is crucial if a nation is to enjoy rising living standards. Fundamentally, a bigger pie means that everyone should be able to get a bigger piece of that pie. Ceteris paribus, economic growth should result in higher living standards, more employment and higher incomes. On the other hand, while theoretically growth need not necessarily lead to higher inflation or a worsening balance of payments, recent growth spurts in both the developed and developing world have tended to contribute to both. A further risk of too-rapid growth can be environmental damage, as evidenced by the appalling

air quality in many of the developing world's metropolises. To try to account for environmental impacts, some economists have tried to introduce 'green GDP' measures which try to offset the costs of environmental degradation against increases in the output of goods and services.

Overall, though, measures like GDP that capture simple economic growth do not allow us to meaningfully compare living standards between countries or over time. First of all, even GDP per capita figures tell us nothing about how income is distributed. If a country has a few very wealthy families and a mass of very poor families, it may nonetheless have an acceptable per capita GDP that would make it appear to be as pleasant a place to live as a similar country with a more equitable income distribution. Secondly, GDP per capita figures, converted into a common currency at market exchange rates, tell us nothing about the different purchasing power of those amounts in their respective countries. For instance, a GDP per capita of $50 000 US in India would suggest a very different lifestyle than would be possible using the same amount in Switzerland. However, looking at GDP per capita figures using purchasing power parity (PPP) exchange rates (which value currencies against one another based upon their relative purchasing power, and not on their value on the foreign exchange market – the best example is The Economist magazine's "Big Mac Index") can help to clarify such comparisons. Lastly, GDP does not take into account what was produced. A country such as the ex-Soviet Union may have had a decent GDP per capita, but as around half of the country's output towards the end of the Soviet era was directed towards the military, Soviet GDP per capita figures did not accurately represent the standard of living of the people.

Economic development is a more qualitative concept that tries to overcome these difficulties by looking at a broader set of measures that are intended to better capture improvements in a country's standard of living. While economic growth is involved, along with increased per capita income, education, health and environmental measures are also included. The reason these other factors are included in most measures of economic development is that they increase people's choices in life. Fundamentally, economic development is about human development. Any improvements that allow people to do more or be more in life contribute to economic development.

The most common measure of human development, the **human development index** (HDI) developed by the United Nations, combines measures of GDP with measures of health (life expectancy) and education (mean years of schooling and expected years of schooling). People with enough income can meet their material needs, and once those are met, education gives people choices – you know what is possible and you can prepare to achieve your goals. Lastly, good health is essential to pursuing these choices.

Economic development can also be assessed by looking at the following indicators:

1. Changes in the structure of the economy and labour force
   Less developed countries tend to have a larger share of output and employment in the primary sector (ie farming). Places that are more developed have more output and employment in the tertiary sector (services).
2. Changes in population structure and urbanization

Less developed countries often have high birth and high death rates (and therefore lower life expectancies), and have a large proportion of the population under the age of 15. As well, they often have relatively low rates of urbanization. By contrast, developed countries tend to have lower birth and death rates, higher life expectancies, and higher rates of urbanization.

3. Changes in cultural values
   Less developed countries tend to have traditional cultures that revolve around survival of the group (the family, clan, tribe), whereas developed countries' cultures tend to value individuality and self-expression. The status of women is a good measure of a country's cultural values.

Other factors can be looked at as well (for instance, energy use per capita), but these 6 tend to capture the differences between less developed and more developed countries fairly comprehensively.

Remember that economically less developed nations are not all the same. Less developed countries are numerous and very diverse. Some may have low per capita income but relatively high educational and health outcomes (Kerala, Cuba) while others may have high per capita income but relatively low health and educational outcomes (many oil-producing nations). The level of per capita income amongst developing countries can vary a great deal as well – emerging nations like Mexico have a GDP/capita of over $10 000 (2008 – Source – World Bank, World Development Indicators) while other countries like Niger only have a GDP/capita of around $364 (2008, same source).

Under the leadership of the United Nations, nations are hoping to achieve the following Millennium Development Goals by 2015:

1. End poverty and hunger	2. Universal education
3. Gender equality	4. Child health
5. Maternal health	6. Combat HIV/AIDS
7. Environmental sustainability	8. Global partnership

EED1

1. Define:
   a. ECONOMIC GROWTH

   b. ECONOMIC DEVELOPMENT

   c. HUMAN DEVELOPMENT INDEX

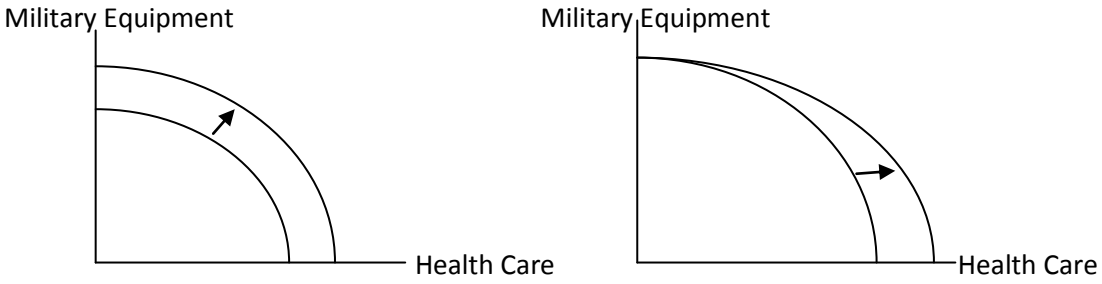
2. The GDP of Elbonia was 130 billion dollars in 2009 and 140 billion dollars in 2010. If inflation was 4% during 2010, what was the real growth in GDP between 2009 and 2010?

3. If Swiss GDP per capita is 100 000 CHF, while Indian GDP per capita is 60 000 Rs:

   a. Convert both figures into US dollars using foreign exchange market exchange rates. How many times more wealthy is the average Swiss?

   b. Now, using the PPP exchange rates from the most recent Big Mac Index, convert both figures. How has the comparison changed? Why?

4. Which PPC below shows simple economic growth and which shows economic development? Explain your answer.



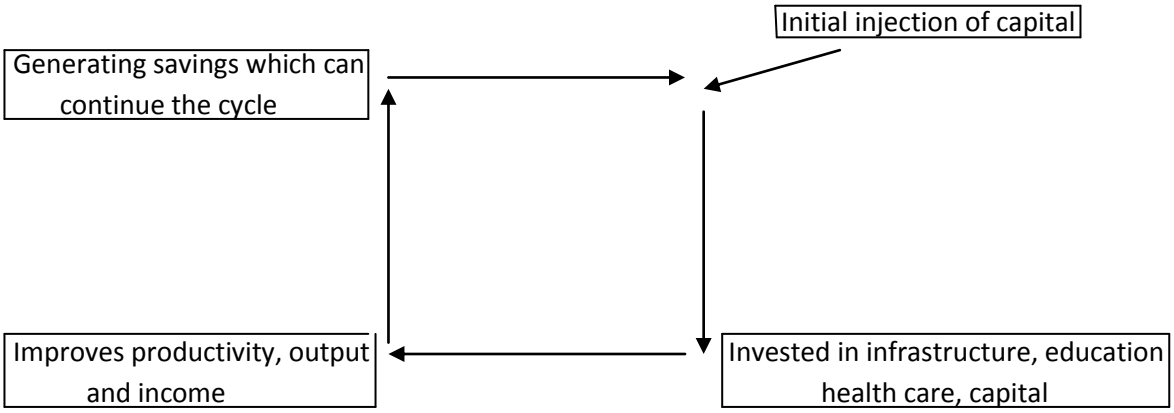
5. Look up the current Human Development Index ranking on the internet (http://hdr.undp.org/en/statistics/). What nations currently enjoy the top rankings? What nations occupy the bottom rankings? Into how many categories are nations grouped? Are there any nations whose HDI ranking is either much above or below their ranking according to per capita GDP?

6. Looking around the same website, look under the headings entitled “Understanding the Data”, and “Composite Indices.” What are some difficulties measuring development with tools such as the HDI? How are composite measures nonetheless still superior to single indicators?

7. Compare two other indicators of health and education (for instance, infant mortality, doctors per 1000 population, adult literacy, spending per pupil per year) for an industrialized nation (GDP/capita > $20 000), a developing nation (GDP/capita around $10 000) and an underdeveloped nation (GDP/capita < $2000). Do the indicators line up as you would expect? If not, why not?

ED2 The Development Cycle

Economic development is actually a pretty simple process in theory. The development cycle below sets it out quite plainly.



This is basically a simple "invest wisely for a comfortable retirement" strategy. The questions that matter in development economics are how best to get the initial injection of capital, and then how best to ensure that the capital is used effectively and not wasted or lost.

Looking at the second question first, as in the circular flow diagram, there are some significant leakages which can make economic development almost impossible. They are:

1. Weak governmental and legal institutions

If a country does not protect property rights or contract law effectively, the result will inevitably be corruption and political illegitimacy and instability. This will, in turn, discourage investment, leading to a large informal sector, which will in turn both make the income distribution unequal and make it difficult for the government to collect taxes. If the government cannot collect taxes, it is weak, and cannot provide services like education or health care or build infrastructure. This further undermines the government's legitimacy, fuelling further instability in a vicious circle.

2. Weaknesses in the domestic and inequities in the international financial system

If a country has an ineffective banking system, savings are often misdirected and wasted. The goal of a banking system is to direct people's savings to sound investments. The international financial system, meanwhile, has often lent money to poorer nations that they are now having difficulty repaying. The repayments on these loans from the past, often from regimes that are no longer in power, often take up a large proportion of a country's export earnings, making it difficult for countries to finance their own development.

3. Inequities in the international trading system

Many developing countries rely on a limited range of commodities for their export earnings. This means that their export earnings are volatile and in long-term real decline. Further, often these countries find it difficult to sell their produce in developed country markets as they face stiff competition from heavily subsidized domestic agricultural produce. Lastly, they often find it difficult to develop higher-value-added manufacturing export industries.

Looking at how best to get the first initial injection of capital, there is debate about the relative merits of each of the following:

1. Foreign aid

Is aid an effective way to get the initial capital necessary to fuel economic growth? This is a very heated debate, with many NGOs (non-governmental organizations) and economists like Jeffrey Sachs arguing to "make poverty history" through increased aid, and many other economists and thinkers, such as Dambisa Moyo, arguing that foreign aid, by weakening the political legitimacy of developing countries, has actually impeded the economic development of many countries, particularly in sub-Saharan Africa.

2. Trade

Here, the debate is whether it is best for a country to adopt protectionist policies or engage in free trade in the pursuit of development. Historically, it can be seen that *every* developed country went through a period of heavy protectionism while they developed their industrial sectors. However, there are also examples of countries that have failed to industrialize despite enacting protectionist policies. Similarly, there are examples of countries which have thrived economically with free trade, such as Hong Kong, and others which have remained stuck as commodity exporters.

3. Foreign Direct Investment

Here, the debate is whether foreign direct investment (FDI) by multinational corporations (MNCs) contributes to economic development or is simply exploitative. Generally, where MNCs invest and train workers and spread modern management practices to their indigenous suppliers, they make an important contribution. However, there are also examples of MNCs, often involved in resource extraction or textile production, that make almost no such contributions and who leave once the resource is exhausted or wages rise above subsistence.

4. Loans

Loan from either commercial banks or from multilateral lenders like the World Bank have been seen in the past as a way for developing nations to acquire the capital needed to 'kick-start' the development cycle, but the problems associated with repaying loans taken up in the past has diminished the appeal of loans as a development strategy. However, micro-credit loans granted often by non-profit non-governmental organizations are increasingly seen as an effective weapon against poverty.

These debates are all fruitful, but the frustrating thing about economic development is that there is no 'one path' that works everywhere. A country's particular culture and history matter at least as much as, and usually more than, any uniform economic prescriptions.

EED2

1. Add the potential leakages and different sources of initial capital outlined in the lesson to the development cycle diagram.

2. What might a 'poverty cycle', trapping poor nations in poverty, look like?

ED3 Different Theories of Development

Development economics has gone through quite an evolution since the early 20th century. One of the first thinkers to ponder the question of 'why some countries are wealthier than others' was Harold Innes, who in the 1920s came up with the Staples Thesis to explain Canadian economic development. The Staples Thesis states that the exportation of raw materials can trigger sustainable economic growth, while its critics argue that a reliance on commodity exports can constitute a development trap. Nonetheless, many countries have earned the surplus capital to begin the development cycle through the exploitation and export of raw materials. Obviously this applies to the United States, Australia, and other 'new world' nations where an abundance of raw materials greeted the first European settlers. Less obviously, it also applies to many European countries (the UK, France and the Netherlands) whose vast earnings from Caribbean sugar plantations financed productivity improvements at home. These improvements at home were often in agriculture. Growing rural productivity and prosperity stimulated demand for more manufactured goods, which drew workers from the countryside into the workshops of the growing cities, where they were more productively employed and where they demanded more produce from the countryside. This extra demand for food further stimulated agricultural productivity improvements, and so town and country ratcheted each other up in a very virtuous circle of rising productivity and income.

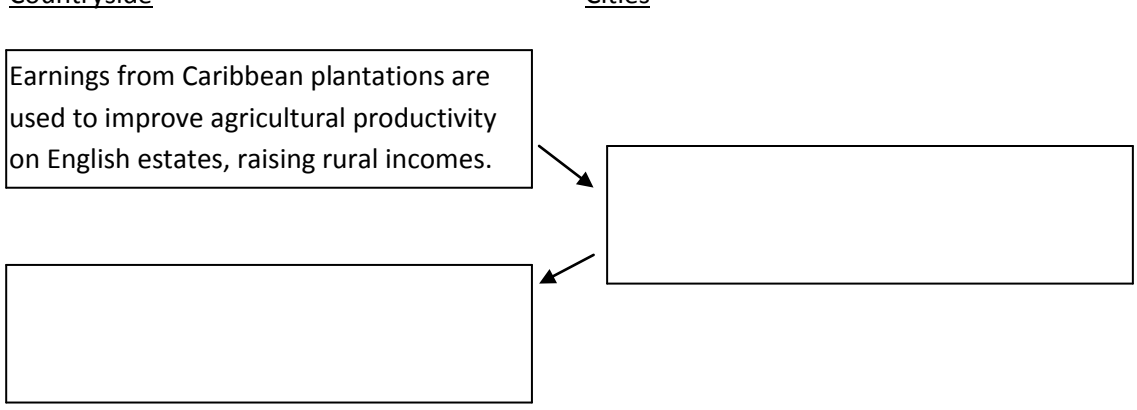
This theory of economic development explained things well until the surprising emergence of Japan as an industrial power in the early 20th century. The question that Japanese economic development posed was 'how could a small, populous island with no natural resources nonetheless develop?' Thinkers looking into the Japanese exception in the 1940s and 1950s found that while Japan had no raw materials to export, it did have an agricultural sector and peasants to exploit. One of the most important things done during the Meiji era was to reform the land tax on agriculture. This tax earned a great deal of revenue for the government and allowed the government to invest in things like infrastructure and education, and later, to finance the growth of heavy industry. After reflecting on the Japanese example, development theorists emphasized the importance of simply getting the necessary investment capital in whatever way possible. While for countries like Canada this had been through the export of raw materials, for other countries taxes or loans or even foreign aid were thought to be equally effective.

When large swathes of the developing world became independent in the 1960s, these capital theories (such as the Harrod-Domar model) were very popular. Advised by the best economists, the governments of these newly independent countries eagerly borrowed money from banks and from the World Bank to finance their industrialization and development. As well, many developed countries gave significant amounts of foreign aid to these countries to further fuel their development. However, by the 1970s it was clear that this strategy had not worked. Rather, newly independent countries which may have celebrated independence with positive cash balances and reasonable levels of infrastructure and income found themselves saddled with debt, declining real incomes and deteriorating infrastructure. What went wrong?

From the 1980s onwards, a lot of the best work in development economics has looked at the importance of institutions and political development. Unlike the newly independent nations of, in particular, sub-Saharan Africa, Japan was a long-established nation with high standards of public accountability. The officials (often nobles) who were in charge of Japan's modernization were nationalist in the best sense of the term – motivated to protect and advance the Japanese nation. Thus, little of the money raised by the land tax was wasted. While the peasants did suffer in the late 1800s, their suffering was not in vain as subsequent generations of Japanese have enjoyed growing economic prosperity. Other thinkers like Hernando de Soto, in his book "The Mystery of Capital", have found that in many places the poor are shut out of economic development by laws that make it difficult to register land titles or businesses, resulting in what he calls 'dead capital'. Still, others have pointed out the importance of universal primary education and health care, while still other thinkers have emphasized the importance of an economy and culture being open to new ideas. In the Japanese case this was clear as the Japanese sent students to the best universities around the world and hired foreign experts to advise them when they established their modern industries and infrastructure. Overall, then, theories explaining economic development have become more nuanced. The EGOIN theory of Dr. Lim Chong Yah, to take one example, states that development depends upon education (E), good government (G), openness to new ideas, or social infrastructure (O), investment in physical infrastructure and industry (I), and natural resources (N). Unsurprisingly, this theory, which emphasizes education, openness and good government, comes from Singapore, a free trading port with a remarkably non-corrupt government and effective school system.

EED3

1. a. Use the boxes below to show how extra capital from sugar plantations in the Caribbean led to improvements in both the agricultural and manufacturing industries in England in the 1700s.



b. Do some research, and find out about some of the specific improvements that contributed to increased agricultural productivity in 17th and 18th century England.

2. Which theory of development best describes the experience of the country you are living in? If the country is not economically developed, which factor(s) in the EGOIN model have not historically been in place?

ED4 The Role of Domestic Factors

A country's domestic policy choices make a big difference in the rate of economic development. First off, a nation which makes an effort to ensure universal literacy and access to health care is sure to reap the benefits in future years as a better educated and healthier population should, other things being equal, be more productive and hence more prosperous. Interestingly, authoritarian regimes are often more successful at attaining good outcomes in these areas, as evidenced by Saddam Hussein's being recognized by UNESCO for creating one of the best public health systems in the Middle East while he served as vice-president of Iraq in the 1970s. More immediately, nations which develop needed **infrastructure** (without overdoing it and getting into debt) also lay the foundations for future prosperity. Without roads, for instance, farmers cannot bring their produce to market and merchants cannot bring their goods to the countryside. Without a reliable telephone or telecommunications system, similarly, interactions between merchants and producers are made more difficult. Infrastructure also helps with security, which is perhaps the most important precondition for economic development. In countries with civil wars or rebellions, economic development is impossible. Good roads and communications systems tie nations together and help areas on the periphery gain access to the resources of the centre and the attention of thecentral government. This tends to make people in remote areas less likely to rebel in order to advance their interests. Lastly, a government that is seen as being effective in providing infrastructure and services gains the respect of the population, which regards it as legitimate and is thus also less likely to want to overthrow its rule.

A sound banking system, as mentioned earlier, routes the savings of a country to its best investment opportunities. This fuels growth. Some countries, notably China, waste a great deal of their people's savings lending money to loss-making state-owned enterprises. In very poor countries where most people are excluded from the banking system, micro-credit schemes have proven to be effective in reducing poverty. **Microcredit schemes** involve making tiny loans (ie $100) to mainly women in order for them to start small businesses. These women must attend classes on managing money, and must promise to start saving money in a savings account when they start to repay the loans. Once they get the money, they meet in groups to discuss their businesses and their finances. As you can see, this is as much an educational and social program as a lending program. The women gain confidence and status in their households, and this has a huge impact on birthrates and on child health and educational outcomes which are essential to economic development. Improvements in the status of women and economic development tend to go together, with each reinforcing the other. As well, as the recipients of microcredit loans are poor, microcredit schemes also improve income distribution, which further aids development.

The development of **appropriate technology** for industry and agriculture is another area where domestic policy choices can make a big difference. For instance, Cuba, after oil imports from the Soviet Union dried up in the early 1990s, faced a real problem as its agricultural sector was dependent on chemical fertilizers and modern farm machinery. In response, the government encouraged people to take up organic farming on small plots. As a result, the people of Cuba are now well-fed and agriculturally self-sufficient. Economic development that depends upon foreign machinery or inputs is at

risk of being disrupted by shortages of foreign exchange to buy spare parts or materials, even though on the surface it may appear to be more efficient.

EED4

1. Define:
   a. INFRASTRUCTURE

   b. MICROCREDIT SCHEMES

   c. APPROPRIATE TECHNOLOGY

2. "The first task of a government is to secure the lives and property of its citizens." Discuss what governments can do to ensure this, and how doing so promotes economic development.

3. How can good infrastructure directly help governments ensure the security of their citizen's lives and property?

4. Why do you think micro-credit schemes initially focused on lending money to women? What have been some ancillary benefits of doing so?

5. Look up http://www.youtube.com/watch?v=CDPKDgOMpBo, or look up "Playpumps international." What is it that makes these pumps an example of appropriate technology? Look up another example of appropriate technology.

6. Why are many people in less developed countries excluded from the banking system? How does this inequality of access to capital get in the way of economic development?

7. A criticism of microcredit schemes is that while they create jobs in petty trade (ie cobbling, tailoring, food preparation) they do not create jobs in the formal economy. Taking a longer view, though, how might they contribute to economic development over time?

ED5 Trade as a Development Strategy

As was discussed in lesson ED2, developing countries face problems from over-specialisation in a narrow range of products, which are usually commodities (like cotton, rubber, cocoa, sugar) which can have significant price volatility. This makes it hard to plan national budgets or have predictable exchange rates. These in turn can make it difficult to develop secondary or tertiary industries. As well, we talked about how farmers in Europe and America enjoy generous subsidies which not only deprive developing world farmers of much-need export markets but which also drive down the world price of commodities like cotton and sugar, hurting export earnings and worsening developing nations' terms of trade over the long term. Lastly, while primary products which are not grown in developed countries like coffee or cocoa beans may be able to be exported to the developed world without tariffs, often more finished goods, like prepared coffee or processed chocolate are subject to restrictions (http://www.dw-world.de/dw/article/0,,5127705,00.html).

Faced with these inequities, countries can choose to adopt a policy of **import substitution**. This involves protectionism to allow domestic industries to replace or reduce the role of imports. In many countries, there are domestic products that mimic international brands, especially for goods that are not very difficult to produce like potato chips or soft drinks. Sometimes the industry protected is more complicated, such as automobile manufacturing. The classic example of this comes from Malaysia, the home of the Proton automobile. Malaysia put high tariffs on car imports to encourage Malaysians to buy the domestically produced Proton. This was to help Malaysia diversify its economy by encouraging the development of not only a car industry, but all the other industries that go along with it. At other times the protected industry is directly downstream of an existing primary industry. For instance, a country that exports raw logs may wish to develop a lumber or paper industry.

The other choice is to pursue an **export promotion** strategy that encourages exports in certain sectors and accepts imports in all other sectors. This strategy calls for trade liberalisation and often involves bilateral or regional trade agreements to be pursued and signed. Singapore has pursued this policy quite successfully since independence in 1965, helped by its history as a duty-free port. Singapore's government targets and helps certain sectors to become internationally competitive based upon its comparative advantages in its labour force, regulatory regime, and geographical location (for instance, trade, electronics and finance). Other sectors in which it does not enjoy a comparative advantage are then left open to foreign suppliers. For instance, as Singapore is a small island city-state, it depends almost entirely on imported food.

The two strategies each have their appeal. For large nations with a diverse resource base, import substitution may be viable and may be one of the only ways to achieve industrialization. Again, countries like the United States, Germany and Canada all pursued import substitution policies while they weaned themselves off imports of British manufactured goods. However, for small nations like Singapore which cannot hope to be self-sufficient due to the constraints of its geography, pursuing an intelligent policy of export promotion has a better chance of improving living standards. Small nations

need to be relevant to other nations in order to survive and be prosperous, and they can only be relevant if they specialise and are the best in the world or at least their region in some areas.

EED5

1. Define:
    a. IMPORT SUBSTITUTION

    b. EXPORT PROMOTION

2. In the event of a global recession, which strategy, import substitution or export promotion, is likely to yield better domestic macroeconomic results? Why?

3. Why is import substitution a practical strategy for China or India or the United States but an impractical strategy for Switzerland, Uruguay or Botswana?

4. What were developing nations, led by India, demanding at the collapsed Doha round of WTO negotiations? What would be the advantages to developing nations of there being one set of rules governing global trade through the WTO as opposed to having to conform with a multitude of regional and bilateral trade deals?

5. Think of some examples of goods sold domestically in your country that could be interpreted as attempts to practice import substitution. What makes them attractive to consumers?

6. Why are nations wishing to pursue economic development more or less compelled to participate in the global trading system? What do they need from developed nations?

ED6 The Role of Foreign Direct Investment

Foreign direct investment (FDI) is when foreign companies, usually **multinational corporations** (MNCs), build facilities (for production, research or distribution) in a country. It is distinguished from portfolio investment because it implies a much higher level of commitment, as it is much more difficult to sell or close down a plant or other facility than to sell a stock or bond.

Multinational corporations have good reasons to invest in developing countries. First, developing countries often have natural resources that can be best exploited using their technology and know-how. This is most clearly the case with international oil and mining companies. Shell or Exxon have the technology and expertise to explore and develop oil reserves in locations or at depths that local oil companies do not. Similarly, mining companies like Barrick or Rio Tinto or BHP have the expertise to develop mines in difficult areas and at depths that local companies cannot match.

Second, developing countries may offer productive resources like labour at a lower cost than developed countries. For relatively labour intensive and low-skilled industries like textiles and garment making, the cost savings from relocating production to a less-developed country with cheaper wages more than makes up for the inconveniences (and higher costs) of operating without developed country infrastructure and institutions.

Lastly, developing countries offer access to large and often fast-growing markets. As such, it makes sense to establish production and marketing facilities near these markets. Companies like Unilever, which makes soap, have expanded aggressively in the developing world (ie India) to increase their sales there, which are growing much faster in India than in developed world markets.

For the developing countries, there are both advantages and disadvantages to FDI by MNCs. If the developing country is attractive to the MNCs based upon the quality of its labour force or the quality of its institutions and infrastructure or the size of its potential market, it is more likely to attract MNCs interested in forming a long-term relationship with the country. This has several benefits. First of all, the MNCs will provide stable jobs. Second of all, the people taking up these jobs will have access to the latest technology and management techniques, and will be trained in them. This will put pressure on domestic firms in the same industry (and most especially any domestic suppliers to the MNC) to adopt the same technologies and management practices, so improving productivity throughout the economy. Basically, MNCs can be a window to the outside world, through which the best global ideas and practices can enter. Lastly, MNCs generally have higher environmental and labour standards than domestic firms in developing countries, so they exert a positive influence in these areas as well.

On the other hand, particularly where the MNC is interested only in exploiting either a natural resource or cheap labour, there is a risk that the MNC will come to that country only so long as the resource is there or the labour remains cheap. The challenge then is for the country to make its labour force, institutions and infrastructure attractive enough to entice the MNC to stay despite the depletion of the resource or higher wages and so contribute to its economic development.

EED6

1. Define:
    a. FOREIGN DIRECT INVESTMENT

    b. MULTINATIONAL CORPORATIONS

2. If you had the choice of working for a domestic firm or a multinational firm, which would you likely choose? Why? What does this suggest about their labour practices as compared to purely national firms?

3. Why are multinational firms likely to follow stricter labour and environmental standards than domestic firms in developing countries?

4. Many countries offer tax holidays to MNCs to establish plants or facilities in their countries on the condition that they employ and train a certain percentage of local workers in their operations and management practices. How does this serve to both keep the MNC in the country longer and protect the country if the MNC does decide to leave?

5. Some MNC garment or shoe makers will stay in a country with cheap labour until wages rise enough to make it more profitable to move to a country with still cheaper labour. While this can be looked at as disloyal, what contribution has the MNC clearly made to the economic development of the country?

6. What is often the attitude of the people and governments of developing countries towards multinational oil and mining firms? Look up an example in your own country or a country you are familiar with. Why do you think these attitudes are held?

ED7 The Aid Debate

The logic of foreign aid is simple. In poorer nations with low incomes and low savings, it is thought that aid can provide the capital to kick-start the development cycle. Foreign aid can take many forms, and can be subdivided up in a few ways. First, all aid can be either bilateral, that is between a developed and developing country's governments, or multilateral, which is when donor governments give money to international organizations like the World Bank and the International Monetary Fund which then in turn give it to developing country governments. Non-governmental organizations such as the Mennonite Central Committee are also important contributors of aid. The biggest distinction when it comes to foreign aid is between emergency aid and development aid. Emergency aid (or **humanitarian aid**) takes the form of food, tents and medicine in response to a disaster. This disaster could be a natural disaster (earthquake, tsunami etc.) or it could have human origins (conflict, drought resulting in famine). This sort of aid is hard to argue with. In times of desperate and pressing need, we have a responsibility to respond with help.

Development aid, given to promote the long-term economic development of a country, can take many forms. It can take the form of financial aid, which is the provision of grants or loans to developing countries. In order to be counted as aid, the loans should be what are called **'soft' loans** which feature lower-than-market interest charges. Technical aid is where the donor country gives technology (such as hydro dams, electricity or telecommunications systems) to the developing country and sends trained technicians to install it and train locals to take over its operation. Often this type of aid is **tied aid**, where the developing country must accept the technology and the technicians provided by the donor country, even if another country's technology may be better suited to their needs. Lastly there is education aid, where promising students from the developing world are given scholarships to study at universities in the developed world.

Historical experience suggests that foreign aid has not been very effective in promoting economic development. With most government to government aid, there have been problems with the distribution of the aid. Governments in developing countries can become used to aid financing their operations and so become more attuned to currying favour with donor nations than responding to the needs of their own people. Controlling the flow of foreign aid becomes an important tool in maintaining power, and can prop up unsavoury regimes that are otherwise actively impoverishing their nations. Without strong institutions, flows of money can and often do fuel corruption. Tied aid can be seen as more a way for developed country governments to subsidize their own corporations than as a way to help developing nations. For instance, Canadian government aid for many years consisted of donating Canadian-made tractors to developing nations whose farmers could not afford to operate or maintain them, with the result that after a short time the tractors were rusting in fields. At the end of the day, the biggest beneficiary of this aid was the tractor company. Lastly, education aid often contributes to what is called the 'brain drain', where talented people from poorer countries move to richer countries to work. This loss of quality human resources cannot but harm the developing country's prospects.

Overall, the biggest problem with development aid, as looked at by thinkers such as Theodore Dalrymple or Dambisa Moyo, is that it removes incentives for governments to take responsibility for their own economic development. Aid does promote a culture of dependency and can retard the political development upon which economic development ultimately depends. Governments dependent upon aid to function do not need to raise money from taxes. If people are not being taxed, the government does not need to respond to their needs in order to function. The government can then operate in an arbitrary fashion, concerned only with controlling the flow of aid. Eventually, though, the failure of the government to provide essential protection and services will undermine its legitimacy enough to provoke rebellions and coups. This political instability itself will make economic development almost impossible. More damaging, though, endless cycles of political instability make it very unlikely that a government will ever make development a priority, as it doesn't expect to be in power long. Thus, governments degenerate into gangs of looters, concerned only to loot as much as they can before they in turn lose power. The entrenchment of a culture of looting is the final nail in the coffin of economic development. Why try to build a business or a farm if it is likely to be taken from you by the current gang in the government? When people become discouraged and stop trying to improve their lives, economic development becomes impossible.

EED7

1. Define:
    a. HUMANITARIAN AID

    b. DEVELOPMENT AID

    c. SOFT LOANS

    d. TIED AID

2. The British government's largest development aid project was the construction of the Pergau dam in Malaysia. Look up some news articles online about this project. In what ways is this project an example of the problems associated with aid as a development strategy? Contrast this project with Danish development aid to Malawi. How were the aims and objectives and achievements of the different aid projects different?

3. How might a dependence on foreign aid in developing countries skew the occupational choices of the best and brightest students in the country? What careers might they choose that may not be in the best interests of their country's development? How might a focus on encouraging trade result in more sustainable economic development?

ED8 The Problem of Indebtedness

There have recently been calls for developed nations to forgive the debts of developing nations in an attempt to restart or improve their prospects for economic development. This action can be justified in a number of ways, but it creates problems of moral hazard (ie if you are protected from the negative consequences of your reckless actions, you are more likely to be reckless in the future) as well, as if nations learn that they can borrow and not be expected to pay back the loans, they are less likely to be prudent in their borrowing.

First, it is obvious that high levels of indebtedness do impede economic development. If a large proportion of a country's export earnings are used to pay the interest on debts incurred in the past, clearly there is not much left over to pay for the capital goods and infrastructure needed to move the country forward. Debt forgiveness would free up export earnings for economic development.

Secondly, if we look at how the debts were incurred, it also seems just to forgive them. Again, the 1973 oil shock played a major role. After the Arab oil embargo, oil prices tripled, and the export earnings of the major oil producing and exporting nations exploded. The oil exporting countries could not hope to spend this windfall domestically as such a sudden increase in spending would only fuel inflation. So, they deposited their additional oil revenues in international banks in New York and London. As banks make money on loans, not deposits, this sudden increase in deposits caused them to seek out new borrowers. Stagflation and an uncertain economic outlook in the developed countries meant that businesses there did not have a great appetite for loans. So, in response, bankers began to direct their attention to the developing world. At first, things went well, but when inflation spiralled out of control towards the late 1970s, central banks began to hike interest rates to 20% or higher. These higher interest rates were also applied to the loans made to the developing countries, making it almost impossible for them to repay the interest on the loans, let alone the loans themselves. By the early 1980s, developing nations began to default on their loans, which blocked their access to further credit, bringing economic growth and development to a shuddering halt.

More generally, often the debts were incurred in a fashion that allowed bankers and businessmen from the developed world to benefit alongside politicians and leaders from the developing country at the expense of the developing country's population. The process is often portrayed as follows:

1. A country with weak institutions seeks loans to build infrastructure or industry.
2. A loan is granted (on condition that it is used to engage the services of a well-connected multinational engineering or industrial firm), often for a greater-than-necessary amount.
3. Contracts are awarded, and kickbacks are given to the relevant government ministers. The project is completed. The government ministers and the multinational companies have the money, and the country has the debt.
4. Eventually, the countries have a hard time repaying these large loans, which causes them to seek help in 'rescheduling' their payments to the banks. Often, the banks (in concert with the World Bank and International Monetary Fund) will impose conditions or seek concessions in exchange for rescheduling the debt that increases their control over the country's economy.

The writer John Perkins, in his book “Confessions of an Economic Hit Man”, has asserted that this process is standard practice for the governments of developed countries in order to assert political and economic control over developing nations, but this assertion is very difficult to prove.

The role the World Bank and the International Monetary Fund play in all of this is controversial. On the face of it, the **World Bank** is concerned with making loans to developing countries in order to assist in their economic development. The **International Monetary Fund**, meanwhile, is concerned more with assisting countries facing urgent balance of payments and currency crises. Generally, the World Bank makes long-term loans while the IMF responds quickly with emergency loans. Critics of the two institutions (which, together with the World Trade Organization shape the global economic order) charge that the World Bank often makes loans which end up crippling developing nations with debt while IMF structural adjustment programs undertaken in response to persistent balance of payments deficits often hurt the poor in developing nations the most. However, against these criticisms it must be remembered that developing nations themselves apply for World Bank assistance and that by the time a country seeks the help of the IMF it is already facing a balance of payments or currency crisis.

EED8

1. Define:
    a. WORLD BANK

    b. INTERNATIONAL MONETARY FUND

2. What is often required of countries under a structural adjustment program demanded by the International Monetary Fund? Why might such changes in policy hurt the poor? How do such policies hurt the development prospects of the countries that are forced to follow them (look this up online, with reference to IMF intervention in Thailand in 1997 or Argentina in 2001)?

3. How does external debt threaten the sovereignty of developing nations?

4. How could stronger domestic institutions in the developing countries themselves make it harder for them to become indebted and lose sovereignty as a result of debt?

ED9 The Balance between Markets and Government in promoting Economic Development

Economic development really is about policy choices. There are elements of luck involved as well, of course (ie the presence of natural resources, proximity to wealthier neighbouring countries, having ports, having a climate amenable to farming, having a culture that values risk-taking and enterprise), but even controlling for these variables, we can find some nations which are wealthier than others. What policies can help to encourage economic development?

There is a place both for government intervention and for free-market incentives. Generally, development depends upon governments performing their traditional roles well, namely by:

1. Providing an environment of safety and security where people's lives and property are protected by law enforcement agencies
2. Providing a transparent legal and regulatory system to make it easier for people, both nationals and foreigners, to establish and operate businesses without undue interference from government officials
3. Condemning and actively prosecuting corruption on the part of government officials, and thereby upholding the rule of law with respect to contracts and property to protect both foreign and domestic firms and individuals
4. Providing quality infrastructure in terms of roads, ports, airports and telecommunications to facilitate trade and investment
5. Providing universal primary education and access to quality secondary and tertiary education
6. Providing basic health care to all to reduce preventable illness and death, and maybe even
7. Providing adequate housing to all to ensure that no one gets left behind and that all citizens have a stake in the success of the country

These are things that governments the world over need to do. The problem sometimes is that governments become impatient for industrialization and seek to not just provide the preconditions for industrialization and economic development, but the industrialization itself. Generally, **interventionist growth and development policies** of this kind have led to poor outcomes. State-led industrial development was the policy followed most notably by India after it gained independence from Britain in 1947, and the result of the extensive regulation, protectionism and public ownership this policy required was pervasive corruption, a very low rate of economic growth and consequently very little economic development. The contrast with, say, Singapore or South Korea is instructive. In these places, the governments pursued **market oriented growth and development policies** that left business to business, and while they may have protected or subsidized some industries thought key to the economic health of the country, mostly they focused on improving health, education, infrastructure and administration to manage the income inequalities and limit the extent of the market failures that can accompany rapid growth and development.

The thing with economic development is that it takes time. A sustainable increase in per capita income allows this generation to complete primary school, the next generation to complete secondary school, and the generation afterwards to attend university. Clearly, one or more generations are required. This

is immensely frustrating to leaders and to the people they govern, but we should always remember that short-cuts to utopia tend to bring us somewhere entirely different. And we should also keep some perspective and remember that economic growth and development happen much more quickly now than in the past. It took Britain, the first country to transform itself into a modern industrial economy, much longer to achieve its current standard of living than Singapore, which by most measures is about as well off as its former colonial ruler. As well, it can be argued that because of advances in our understanding of public health and due to improvements in technology, it is now possible for people to live longer, richer lives without needing to have as high a level of per capita income as in the past. For instance, while Britain was going through industrialization, sanitation was not understood as being essential for public health, and so while Britain became wealthier, many people were still dying from water-borne diseases like cholera. Now, due to our superior understanding of things such as this, smaller increases in per capita income can result in quite significant improvements in human welfare.

So, looking at the big picture, while there are areas of the world with very low levels of economic development, we must not lose our confidence that, over time, these people can enjoy a sustained increase in their standards of living if we focus our attention on what policy can do, let private initiative and incentives play their role without interference, and appreciate that the modern world allows for faster growth and even faster improvements in living standards than at any other time in history.

EED9

1. Define:
    a. MARKET-ORIENTED GROWTH AND DEVELOPMENT POLICIES

    b. INTERVENTIONIST GROWTH AND DEVELOPMENT POLICIES

2. Why do you think the governments of newly independent countries in Africa and Asia were tempted to pursue policies of state-led industrial development? What was the policy consensus in countries like the UK at this time?

3. What are the risks associated with pursuing interventionist growth and development policies? Look up the example of Indian state-led development from 1947 until 1991.

4. Why is a strong and functioning government nonetheless crucial to successfully implementing market-oriented growth and development policies?

5. Why might economic growth and development be achievable in a more environmentally sustainable fashion in the future than in the present?