

The nature of economic development

è Definition

- Traditional view: capacity of a nation to generate and sustain significant increases in real GDP.
- Modern view: sustained increases in real per capita GDP accompanied by changes in economic & social structures & institutions of a nation as required to reduce incidence of poverty.
- Development is growth plus change - Economic growth is necessary for economic development
 - Economic growth is essentially a rate concept.
 - Economic development - concerned with level of GDP per capita at particular point in time.
 - ‘level of economic development’ is a comparative term - when compared to other countries.

è LDCs: Economists traditionally use a level of real GDP per capita to distinguish advanced from LDCs.

- World bank classification: 1990 cut off figure for real per capita GDP of \$US610 per annum.

è Indicators of development - to judge relative well-being of nation’s people

- Monetary indicators - real per capita GDP figures (weaknesses in *s-growth.doc*)
- Non-monetary (social) indicators of development
 - **Human Development Index**: introduced by World Bank in 1990, socio-economic progress.
 - per capita income with life expectancy, adult literacy & average years of schooling.
 - Construction of HDI reflects a growing trend among economists to focus attention on the ‘human face’ of development and not just upon economic variables.
 - Quality of life for humans has improved 44% since 1980
 - the incomes of the citizens of 15 countries, mostly in Asia, have more than doubled
 - 70 countries have lower average incomes than in 1980 & 43 lower than in 1970.
 - Quality of life has improved 21% since 1980 for 36 countries of Sub-Sahara (bottom 47)
 - UNDP report argues that policy-makers (presumably World Bank) “are often mesmerised by the quantity of growth. They need to be concerned with its structure and quality”.

Contrasts in levels of development

è General contrasts between LDCs and advanced nations

- LDCs: 75% of world’s population - 20% of global GDP. 35% world food & 10% industrial output.
- Advanced: 25% of population - 80% of GDP. Over 60% food & 90% industrial output

è The Widening Gap - cumulative nature of growth ensures gap in income & is becoming larger

è Differences between LDCs

- Natural resource endowments
- population pressure - overpopulated vs. Underpopulated. Size, density and growth rate.
- Growth rates - economic progress varies greatly
- industrial structures - vast majority agrarian - in terms of employment and production. NICs.
- Economic, political, social and cultural frameworks - reflects cultural diversity & ideology.

è Common characteristics of less-developed countries

è Low levels of living	High Income	Indonesia	Philipp.	Mexico	Australia	US
• <u>Energy consumption</u>	13.6 times	279Kg		1383	5211	7681
• <u>GNP per capita (\$US)</u>	60 times	\$US 610	1130	3030	17050	22240
• <u>Population density</u>	L.I. 3 times	95 p/km ²		42	2	27
• <u>infant mortality (/1000)</u>		74/1000		36	8/1000	9
• <u>Life expectancy at birth</u>	15 years	60 years		70	77 years	76
• <u>Illiteracy</u>	L.I. 10 times	23%		13%	<5%.	<5%
• <u>Secondary education</u>	H:90% L:40	45%		53%	83%.	92%

è Low labour productivity - agriculture: labour force much higher than proportion of GDP

- Shortages of capital equipment: result of low levels of domestic saving, attributable to low incomes.
- Shortages of human capital: related to low living standards & limited educational opportunities.
- 4 times more people in L.I than H.I. economies create 5.4% of the output value of H.I. economies.

è **High levels of unemployment and underemployment**

- *Open unemployment*: few jobs available for those willing to work - due to rural-urban migration
- *Disguised unemployment*: Marginal productivity is zero - common particularly in agriculture
- Underemployment: individuals are not working to their full capacity - prevalent in off-peak periods.

è **Substantial dependence on agricultural production** - over 50% of population in agriculture

- Indonesia: 19% of GDP; Thailand: 12%; Mexico: 9%; Australia: 3%
- Agricultural surplus: required to offset CADs & provide domestic saving
- Subsistence production and low agricultural productivity: three reasons for low productivity
 1. traditional farming methods - resistant to change.
 2. Shortage of capital equipment - needed to raise labour productivity
 3. The systems of land ownership and management - landlords and tenants - absentee-landlords.
- Philippines: reliance on agricultural sector has ensured that poverty has remained
 - Of the work-force, 47% are involved in agriculture, contributing 24% of GDP.
- Mexico: 20% of work-force is in agriculture: 9% of GDP

è **Heavy reliance on a few primary exports** - for LDCs, primary products account for 80% exports.

- The need to export - can obtain foreign exchange, an important source for saving.
- Narrow export base - Face the risk that markets may have little prospect for expansion
 - Considerable fluctuations in their export earnings - tend to be more serious in LDCs:
 - exports account for higher proportion of GDP; capital accumulation more difficult

è **Income inequality and economic dualism**

- World Bank surveys: poorest 20% receive 6% of national income; wealthiest 20% receive 51%
- the dual economy: modern market-oriented industrial sector operating along side subsistence sector.
 - Mexico: Dual-economy - large share of Mexico's big exporting firms inputs come from abroad.
- Conspicuous consumption: wealthy spending on unnecessary goods - less capital accumulation
- Demonstration effects: changes in a socio-economic group as a result of contact with another
 - leads to rural migration & changes in culture, consumption & recreation.
- Philippines: Income distribution has hardly changed in 30 years.
 - Most Filipinos live in poverty; tiny middle class; richest 5th have 11 times average income
- China: ratio of disposable income between urban residents & farmers risen: 1.7 (1984) to 2.6 (1996)

Factors inhibiting growth in developing countries

è **Scarcity of physical capital** - trap of underdevelopment - cannot accumulate sufficient capital

- supply of capital - low per capita incomes mostly spent.
- demand for capital - buying power relatively weak, little incentive for investment

è **low levels of domestic saving**

- Household savings: non-income reasons for low levels -
 1. Shortage of banks and other financial institutions - encourages households to hoard
 2. Conspicuous consumption and demonstration effects - diversion to unnecessary luxuries.
 3. Long term indebtedness of the rural population - high interest rates & long repayment periods
- business savings: limited potential for market growth - a disincentive for investment
- government savings: low due to small tax revenue.
- external sources of funds: reliance on foreign investment & foreign aid leads to BOP problems
- Philippines: Starved of foreign investment when Ramos came to power.
 - savings abysmally low - increases need to send 4.5 million to work overseas.
 - Foreign investments to bolster industry since banks incapable of supplying large loans.
- Mexico: banking system is very fragile & in dire need of reform, burdened with up to 25% bad loans.

è **shortage of entrepreneurs**

- poorly developed capital markets & infrastructure; Uncomfortable economic & political climates

è **lack of suitable technology** - some new technologies require enormous amounts of capital equipment

- LDCs find it difficult to imitate modern technology - shortage of skilled labour & entrepreneurs.
- Advanced nations' technology often unsuitable - saves labour & requires economies of scale

è lack of supporting infrastructure

- insufficient social overhead capital - governments sector unable to raise sufficient taxation revenue.
 - restricts labour mobility & retards spread of technology
- South East Asian tigers: subway systems rare in cities; public sewage system not always provided.
 - World Bank: investment of \$400 billion to meet Asia's power needs. Infrastructure: \$1 trillion
 - China: 1,000km²: 108km road & 8km railways, compared to 640km road & 51km rail in USA.
 - Costs more to transfer a container from south China to Hong Kong than from HK to Europe
 - China offering 12% rate of return for build-operate-transfer power schemes - 20% needed.
 - Philippines: Infrastructure poor - roads, railways & telecommunications - disincentive for investment.

è Rapid population growth & high dependency burdens

- Fertility rates in low income economies are more than double those found in high income economies:
 - Indonesia: 3; Philippines: 2.4%; Malaysia: 3.7; Mexico: 3.2; Australia: 1.9.
 - Philippines: 20 years of high growth for Filipinos to reach present average Thai income

è Inflation - (3 times higher) relative scarcity of G&S makes LDCs susceptible to demand inflation

- Indonesia: 7.2%; Philippines: 8.9%; Malaysia: 3.8%; Mexico: 30.6%; Australia: 3.1%
- Reduces real incomes, increases income inequality & lowers living standards
- contributes to balance of payments problems - increases price of export goods.
- Mexico: Peso collapses in 1982, 1987 and 1995. inflation breeds unstable investment environment
 - Until 1995, no truly independent central bank, & unable to control currency fluctuations
 - Debt and Inflation: - threatens to cause another crisis along with relatively high peso.
 - Bulge of payments in 1998 and 1999 totalling around \$35 billion. Financing may cause inflation
 - Mexico's high inflation, over 25%, is working against a stable exchange rate.
 - feared that using foreign reserves to lower freely floating peso could cause another collapse.

è Balance of payments difficulties - persistent CADs

- deteriorating terms of trade & poor access to markets for manufactured goods
- Indonesia: \$6.9b ; Philippines: \$2.5b ; Malaysia: \$6.8b ; Mexico: \$0.6b (surplus) ; Australia: \$15.1b
- Mexico: large CADs & poor economic management contributed to currency crash in January 1995.
 - huge CADs, short-term debt, dangerously low reserves & vulnerable currency.

è foreign debt - 40 heavily indebted poor countries (HIPCs) - debts of at least twice their annual export

- April 1996: World Bank plan for responsible HIPCs to cut debt to "sustainable" levels over 6 years.
 - "Baseline scenario": \$5.6 billion to help 13 countries. G7 cannot agree on funding.
- Mexico: Foreign debt a recurring problem, since January 1995, debts have grown substantially.

è Cultural and political constraints

- Philippines: Recent political unrest
 - 1965-86: Marcos dictator: economic stagnation & endemic corruption
 - Complex political system, inhibits reform programmes & encourages corruption.
 - Mindanao, economic growth in early 1990s barely moved above zero due to political unrest

è Jeffrey Sachs: Why has Africa failed? - Per capita growth is related to:

- initial income level of the country, poorer countries tend to grow faster than rich countries
- extent of market orientation - openness to trade; market liberalisation; private ownership, low tax
- national saving rate - which in turn is strongly affected by the government's own savings rate
- geographical and resource structure of the economy - landlocked & resource-abundant lag behind.
- Study by Sachs and Warner into African Growth:
 - 1970-89: should have grown 1.4% faster than 8 fast-growing developing countries - low start.
 - Growth was actually 3.1% slower - an overall shortfall of 4.5%.
 - Africa actually grew more slowly because:
 - high trade barriers; 1.8%
 - excessive tax rates - highly distorted domestic markets; 0.9%
 - lower saving rates; 1.9%
 - adverse structural conditions - landlocked and resource exports reliance; 0.5%.