THE GLOBAL ECONOMY

(Chapter 14 —> 20)

Chapter 14: International trade Part I

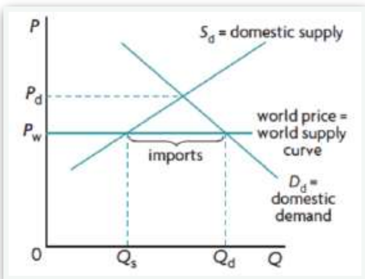
14.1 The benefits of international trade

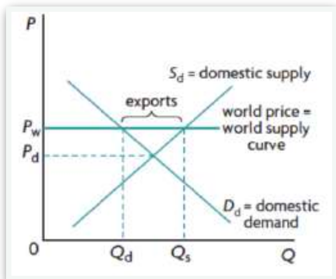
- Free trade —> the absence of gov. intervention of any kind in international trade (no barriers, …)

Benefits:
- Increased competition
- Greater efficiency in production
- Lower prices for consumers
- Greater choice for consumers
- Acquiring needed resources —> need for their domestic production a variety of natural resources or capital goods that are not available domestically
- Source of foreign exchange —> acquiring foreign exchange from exports —> < ability to import
- Access to larger markets —> world market
- Economies of scale in production —> access to larger markets allows firms to grow beyond the limits of national boundaries —> produce more output and take advantage of economies of scale
- Increases in domestic production and consumption as a result of specialisation —> countries concentrate production on one or a few goods and services
- More efficient allocation of resources —> due to specialisation
- Trade makes possible the flow of new ideas and technology
- Trade makes countries interdependent —> reduced possibility of hostilities and violences
- Trade as an "engine for growth" —> contribute to increases in domestic output, so growth

Export or import:

- Autarky (self-sufficiency) —> self-sufficient country in all the goods it produces and consumes
- Export —> if the domestic price of the good without trade is lower than the world price
- Import —> if the domestic prices of the good without trade is higher than the world price



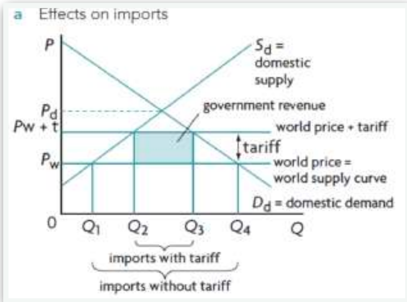


14.3 Types of trade protection

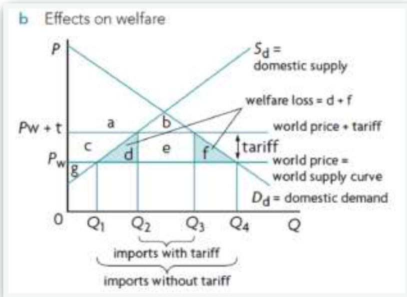
- Trade protection —> involves gov. intervention in international trade through the imposition of trade restrictions (barriers), to prevent the free entry of imports into a country
- To protect the domestic economy (domestic firms and their workers) from foreign competition

Tariffs:

- "Custom duties" —> most common form of trade restriction —> are taxes on imported goods
- Protective tariff —> protect a domestic industry from foreign competition
- Revenue tariff —> raise revenue for the government
- Effects on the economy are the same



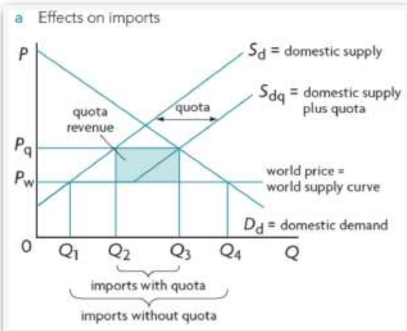
Winners:
- Domestic producers —> producers surplus increases
- Domestic employment in the protected industry increases
- The government gains tariff revenues



Losers:
- Domestic consumers —> consumer surplus drops
- Domestic income distribution worsens —> is a type of regressive tax as people on lower incomes proportionately pay more than people on higher incomes
- Increased inefficiency in production
- Foreign producers are worse off
- Global misallocation of resource results

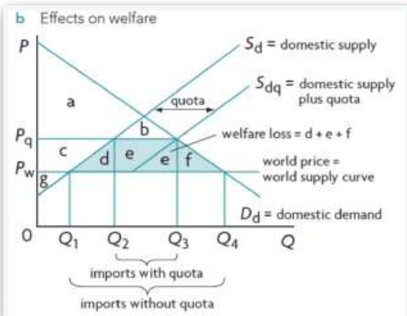
Import quotas:

- Legal limit to quantity of a good that can be imported over a particular time period —> effects of quotas are similar to effects of tariffs, except that they do not create revenue for the gov.



Winners:
- Domestic producers —> greater producer surplus
- Domestic employment increases

Neutral impact:
- The gov. neither gains nor loses —> import licenses to foreign govs.



Losers:
- Domestic consumers —> loss of consumer surplus
- Domestic income distribution —> result in a higher price
- Increased inefficiency in production
- The exporting countries may be worse off or better off —> as they gain the quota revenues
- Global misallocation of resources

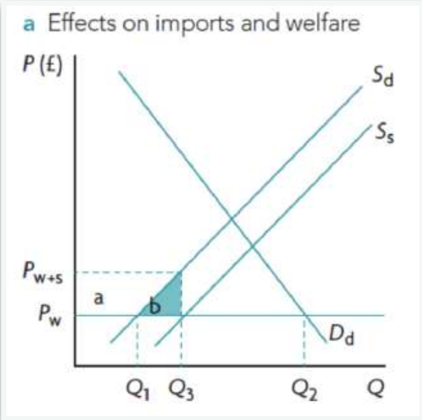
Production subsidies:

- Payments per unit of output granted by the gov. to domestic firms that compete with imports
- Are granted on goods that are produced for the domestic market —> entire quantity produced is sold domestically

Winners:
- Domestic producers —> loss of producer surplus as gov. has to pay
- Domestic employment increases

Neutral:
- Consumers are not affected

Losers:
- The government budget
- Taxpayers are worse off
- Increased inefficiency in production
- Exporting countries
- Global misallocation of resources

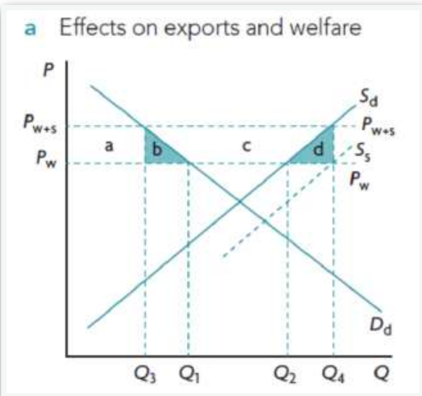


Export subsidies:

- Similar to production subsidies, but is a subsidy paid for each unit of the good that is exported

Winners:
- Producers —> loss of producer surplus as gov. has to pay
- Domestic employment increases

Losers:
- Consumers —> loss of consumer surplus
- Negative effect on the government budget
- Taxpayers are worse off
- Domestic income distribution worsens (increased price for them)
- Exporting countries are worse off
- Increase in global misallocation of resources



Administrative barriers:

- Whenever a good is imported form another country, it must go through a number of customs procedures (inspections, valuation, …) —> are time-consuming, costly and difficult
- Importing countries can impose requirements that imported goods must follow —> quantity of imports is reduced

Chapter 15: International trade Part II

15.1 Arguments for and against trade protection

Arguments for trade protection:

Infant industry argument:
- Infant industry —> is a new domestic industry that has not had time to establish itself and achieve efficiencies in production —> is unable to compete with more mature competitor firms
- They will need protection from imports until they grow —> to high cost of p. at the beginning
- Introduced in 1791 by Alexander Hamilton —> first UA secretary of the treasury
- A country may have a comparative advantage in the production of a particular industrial good, but can't specialise in it unless it first receives some protection
- The gov. must know which industries have the potential to become low cost producers, they could lead to inefficiency as no more a strong competition, and may be a to long protection

National security:
- Certain industries are essential for national defence (weapons, chemicals and minerals) —> should be protected so that country is self-sufficient
- In times of war the country should not have to depend on imports for its defence
- Excuse could be used by industries that have an indirect use in defence (steel) to have protection
- Decisions should be made on political and military —> not economic

Health, safety and environmental standards:
- Countries maintain health, … standards that all imported products must meet before they are allowed to enter —> may be used as a form of hidden protection to keep certain goods out

Efforts of a developing country to diversify:
- Diversification —> change involving greater variety
- Economically least developed countries (ELDCs) —> highly specialised in producing and exporting only few primary commodities —> can be dangerous
- Trade protection policies to keep out imports of goods they would like to produce domestically
- Gov. may not know which products are more appropriate to protect and positive diversification

Arguments which are questionable:

Anti-dumping:
- Dumping —> selling a good in international markets at a price below the cost of producing it
- Is illegal according to international agreements
- If a country suspects that a trading partner is practising dumping it has the right to impose tariffs or quotas —> to limit imports of subsidised or duped goods —> anti-dumping
- Govs. may use it as an excuse to offer protection to their domestic producers even if unjustified

Unfair competition:

- Practices that countries may use in order to gain a competitive advantage over other countries in order to unfairly increase their exports at the expense of other countries
- Countries use those reasons to impose protectionist measure even if not justifiable
- Dumping
- Subsidies to reduce costs of production
- Administrative barriers or hidden protection
- Undervaluing currencies —> exports are more competitive in foreign markets
- Violation of intellectual property —> ideas, trade secrets, inventions, …

Correcting a balance of payments deficit:

- When the outflow of money from a country is greater than the inflow
- Trade protection is a solution as a short-term emergency measure if there is a serious deficit
- Other solutions on the long-term even though

Tariffs as a source of government revenue:

- Frequent in developing countries —> even half or more of all gov. revenues
- Easy to tax imports —> goods that must pass though borders where they can be monitored
- Govs. may rely on tariff revenues as an excuse to delay tax system reforms
- Should be temporary and gradually phased out as countries grow and develop

Protection of domestic jobs:

- Restrictions on imports are needed to protect domestic employment
- If an industry uses imported inputs with restrictions, they will pay a higher price —> higher costs of production and so higher unemployment in the domestic country
- Unemployments increases in the countries that are forced to export less

Impact on stakeholders	Tariffs	Quotas	Production subsidies	Export subsidies	Administrative barriers
Producers	gain	gain	gain	gain	gain
Workers	gain	gain	gain	gain	gain
Government	gain	neutral	lose	lose	neutral
Taxpayers	neutral	neutral	lose	lose	neutral
Consumers	lose	lose	neutral	lose	lose
Domestic society Producer efficiency	lose	lose	lose	lose	lose
Domestic society Income distribution	lose	lose	neutral	lose	lose
Domestic society Resource allocation	lose	lose	lose	lose	lose
Foreign producers	lose	lose	lose	lose	lose
Global society Resource allocation	lose	lose	lose	lose	lose

15.2 Economic integration: trading blocs

- Economic integration —> economic co-operation between countries and co-ordination fo their economic policies —> increased economic links between them
- Countries expect to derive benefits from this
- Begins from agreements between countries to reduce or eliminate trade and other barriers between them + extend co-operation (on labour policies, the environment, monetary, …)

Trade agreements:

Preferential trade agreements (PTA):
- Agreement between two or more countries to lower trade barriers on particular products in trade
- Trade barriers remain on the rest of the products, and on imports from non-member countries
- Sometime involve co-operation between members on other issues (labour standards, env., …)
- Several forms —> free trade areas, customs unions or common markets
  —> bilateral or regional (several countries)

Bilateral, regional and multilateral trade agreements:
- Bilateral TA —> agreement between two countries
- Multilateral TA —> agreement between many countries —> World Trade Organisation
- Regional TA —> agreement between a group of countries that are within a geographical region
- All promote trade liberalisation
- WTO —> aim to reduce trade barriers —> fundamental principle is non-discrimination —> a country cannot impose higher barriers on imports from one country and lower ones from another

Trading blocs:

- A group of countries that have agree to reduce tariff and other barriers to trade to encourage free trade and co-operation between them

Free trade area agreement:
- Countries agree to gradually eliminate trade barriers between themselves
- The most common type of integration area
- Problem —> a product may be improved into the FTA by a country that has the lowest external trade barriers and then sold to countries within the FTA that have higher external trade barriers
- NAFTA (north American), ASEAN (Association of southeast asian nations), …

Customs union:
- Countries that fulfil the requirements of FTA + adopt a common policy towards all non-members
- Involves a higher degree of economic integration than an FTA

- Have the advantage that they avoid having to create complicated rules of origin for imports
- Problem —> coordination on policies toward non-members must be met
- CEFTA —> central European free trad agreement

Common market:

- Countries that have formed a customs union proceed further to eliminate any remaining tariffs in trade between them —> they agree to eliminate all restrictions on movements of any factors of p.
- Enjoy free trade and all its advantages
- Workers are free to move and work in any member country without restrictions
- Capital can flow from country to country without restrictions
- Result in better use of capital resources and improved allocation of resources
- Problem —> requires even greater policy coordination among members
  —> requires the willingness of member govs. to give up some of their policy authority
  —> it is lengthy to do all of this

Evaluating trading blocs:

- Increased competition
- Expansion into larger markets
- Economies of scale
- Lower prices for consumers and greater consumer choice
- Increased investments
- Better use of factors of p. —> improved resource allocation and more employment opportunities
- Improved efficiency in production and greater economic growth
- Stronger bargaining power
- Political advantages —> political stability
- Trading blocs may be a challenge to multilateral trading negotiations (as the WTO)
- Unequal distribution of gains and possible losses —> countries are unlikely to gain equally —> creates the potential for conflicts
- Economic integration involves a loss of sovereignty —> loss of decision-making power

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15.3 Economic integration: monetary union

- Involves a far greater degree of integration than a common market —> when members adopt a common currency and a common central bank responsible for monetary policy
- Example —> euro zone countries

15.4 World Trade Organisation

- Organisation fro liberalising trade

Functions:

- Administer WTO trade agreements
- Provides a forum for trade negotiations
- Handles trade disputes
- Monitors national trade policies —> periodic review of its members national trade policies
- Provides technical assistance and training for developing countries
- Facilitates cooperation with other international organisations

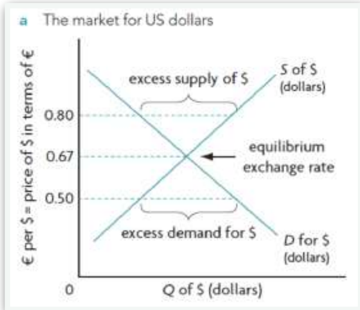
Criticisms:

- The WTO is accused of promoting trade rules that do not favour developing countries
    - —> developed countries received greater tariff reductions than developing ones
    - —> non-tariff and hidden barriers against developing countries wasn't addressed enough
    - —> developed countries influence the agreements
    - —> protection of intellectual property increased cost of acquiring new tech
- The WTO has been unable to reach an agreement on agricultural protection and services
    - —> developed countries protect farmers through production and export subsidies —> has numerous negative effects on the farmers and economies of developing countries
- The WTO is accused of not distinguishing between developed and developing economies
    - —> trade protection lowering was made the same for everyone
    - —> developing countries need trade protections instead
- WTO members have unequal bargaining power
    - —> decisions are based not the power of members in spite of the one vote per member rule
    - —> powerful countries dominate agenda-setting and their opinions carry greater weight
- A key challenge faced buy the WTO: fragmentation of global trade
    - —> global trading system may be facing a setback because of growing trade protection tendencies around the world
- Another key challenge faced by the WTO: the blocking of its powers to resolve disputes
    - —> Appellate body —> seven judges committee
    - —> the US blocked the appointment of new judges of the appellate body in 2019

Chapter 16: Exchange rates and the balance of payments

16.1 Floating exchange rates

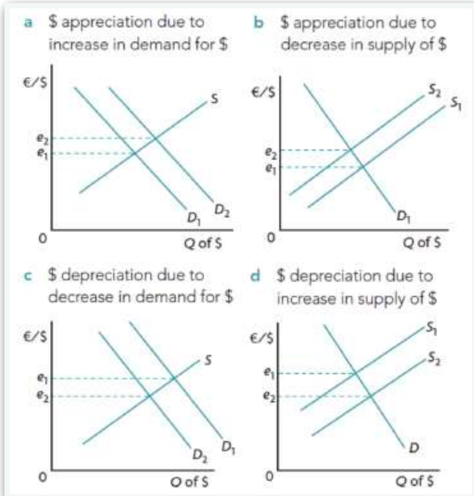
- Foreign exchange —> international transactions involving the use of different national currencies
- Demand for foreign currencies generates a supply of domestic currency in a country
- Demand for the domestic currency generates a supply of foreign currencies in a country
- Exchange rates —> the value of one currency expressed in terms of another



Floating exchange rate system:

- Exchange rates are determined by market forces (demand and supply)
- No government or central bank intervention in the market

Appreciation and depreciation:



- Once an exchange rate settles at its equilibrium value, it will remain there until a change in demand or supply of the currency
- Appreciation —> increase in the value of a currency
  —> all other currencies depreciate relative to it
- Depreciation —> a fall in the value of a currency
  —> all other currencies appreciate relative to it

Causes of changes in exchange rates:

Factors that affect currency demand Inflows of funds		Factors that affect currency supply Outflows of funds	
Increase in currency demand leads to appreciation Figure 16.2(a) D curve shifts right	**Decrease in currency demand leads to depreciation Figure 16.2(c) D curve shifts left**	**Decrease in currency supply leads to appreciation Figure 16.2(b) S curve shifts left**	**Increase in currency supply leads to depreciation Figure 16.2(d) S curve shifts right**
Increase in foreign demand for exports of goods and services	Decrease in foreign demand for exports of goods and services	Decrease in domestic demand for imports of goods and services	Increase in domestic demand for imports of goods and services
Lower inflation leading to increase in foreign demand for exports	Higher inflation leading to decrease in foreign demand for exports	Lower inflation leading to decrease in domestic demand for imports	Higher inflation leading to increase in domestic demand for imports
High growth rates of trading partners leading to increase in foreign demand for exports	Low growth rates of trading partners leading to decrease in foreign demand for exports	Low domestic growth rate leading to decrease in domestic demand for imports	High domestic growth rate leading to increase in domestic demand for imports
Increase in inward investment	Decrease in inward investment	Decrease in outward investment	Increase in outward investment
Higher interest rates leading to more inward financial investment	Lower interest rates leading to less inward financial investment	Higher interest rates leading to less financial investment by domestic residents in foreign countries	Lower interest rates leading to more financial investment by domestic residents in foreign countries
Increase in inflow of remittances	Decrease in inflow of remittances	Decrease in outflow of remittances	Increase in outflow of remittances
Speculators expect currency X will rise so they buy currency X	-	-	Speculators expect currency X will fall so they sell currency X
Central bank buys the domestic currency	-	-	Central bank sells the domestic currency

16.2 Consequences of changes in exchange rates: an evaluation

- Currency appreciation —> expected result in a decrease in net exports (X - M)
- Currency depreciation —> expected result in an increase in net exports (X - M)

Effects on the rate of inflation:
- Demand-pull inflation —> appreciation will work to reduce demand-pull inflationary pressure in an economy —> because it causes AD to fall due to less net exports
- Cost-pull inflation —> appreciation will work to lower cost-push inflationary pressures in the economy by making imports less expensive —> rightward shift of the SRAS curve

Effects on economic growth:
- Depreciation —> increases net exports —> thus increasing real GDP —> short-term growth
  —> increases cost-push inflation —> real GDP may fall due to lower SRAS

Effects on unemployment:
- Depreciation —> causes a fall in cyclical unemployment
  —> due to cost push-inflation —> less GDP —> increase in unemployment

Effects on foreign debt:
- Depreciation —> by lowering the value of the domestic currency it causes the value of foreign debt to increase —> governments try to avoid it for this reason

Effects on living standards:
- Depreciation —> it causes imported goods to become more expensive in the domestic economy
  —> if goods are used as factors of production —> increased cost-push inflation and hence making the cost of living higher

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16.3 Government intervention

- Fixed exchange rate system —> exchange rates are fixed by the central bank of each country at a particular level and are not permitted to change freely in response to the market
- Requires constant intervention by the central bank or government —> in the form of buying and selling reserve currencies by the central bank

Intervention to maintain fixed exchange rates:

- Using official reserves to maintain the exchange rate
- Increases in interest rates for savings
- Borrowing from abroad
- Efforts to limit imports

Changing the fixed exchange rate:

- Devaluation —> if the currency value is higher than what can be maintained
- Revaluation —> if the currency has a lower value than what can be maintained by intervention

- Between 1879-1934 —> gold standard —> countries fixed their exchange rates relative to gold
- 1944-1973 —> Bretton Woods system —> permitted periodic devaluations or revaluations
  —> not against just one other currency but against all other currencies

Managed exchange rates:

- Since 1973 —> exchange rates are for the most part free to float to their market levels over long periods of time —> central banks periodically intervene to stabilise them over the short term
- It prevents large and abrupt fluctuations that may destabilise the economy
- Pegging —> a number of countries peg their currencies to other currencies and float together with it —> the pegged currency is allowed to fluctuate only within a narrow range above and below a target exchange rate relative to the dollar or the euro

Consequences of overvalued and undervalued:

- Often occurs in fixed and managed exchange rate systems
- Overvalued currencies —> imports become cheaper —> developing countries want it to speed up industrialisation
  —> exports become more expensive —> hurts domestic exporters
- Undervalued currencies —> developing countries use them to expand their export industries
  —> competitive advantage compared to other countries —> dirty float

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16.4 The balance of payments

- Balance of payments —> a record of all transactions between the residents of the country and the residents of all other countries
- Shows all payments receive (credits), and all payments made (debits)
- The sum of all credits must be equal to the sum of all debits
- Credits —> create a foreign demand for the country's currency
- Debits —> create a supply of the domestic currency
- Surplus —> when credits are larger than debits
- Deficit —> when debits are larger than credits

Current account components:

- Balance of trade goods —> is the exports minus the imports of goods
- Balance of trade services —> is the exports minus the imports of services
- Balance of trade in goods and services —> net exports —> by summing first two components
- Income —> all inflows (from rents, interests and profits from abroad), minus all outflows
- Current transfers —> inflows due to transfers from abroad (gifts, remittances, foreign aid, pensions), minus outflows
- Balance on current account —> when all items in the current account are added up

- A current account deficit means a country consumes more than it produces —> it pays for extra output consumed through a financial account surplus

Capital account components:

- Capital transfers —> inflows minus outflows for such things as debt forgiveness, non-life insurance claims and investment grants
- Non-financial assets —> the purchase or use of natural resources that are non-produced
- Is relatively small and unimportant compared to the other accounts

Financial account components:

- Foreign direct investment (FDI) —> investments in productive facilities by foreigners
- Portfolio investment —> investments in financial capital
- Reserve assets —> foreign currency reserves that the central bank can buy or sell to influence the value of the country's currency
- Official borrowing —> government borrowing from abroad
- Balance on financial account —> the sum of these items

Errors and omissions:

- It is extremely difficult to record every single transactions —> item called "error and omissions" to fill the gap

Chapter 18: Understanding economic development

18.1 Sustainable development

- Sustainable development —> development that meets the needs of the present without compromising the ability of future generations to meet their own needs
  —> does not deplete or degrade natural resources
- Sustainable dev. goals —> developed by the United Nations Conference
  —> have one to three indicators per target

Goals:

- End poverty in all its forms and everywhere
- End hunger, achieve food security + nutrition, and promote sustainable agriculture
- Ensure healthy lives and promote well-being for all at all ages
- Ensure inclusive and equitable quality education and promote lifelong learning opportunities
- Achieve gender equality and empower all women and girls
- Ensure availability and sustainable management of water and sanitation
- Ensure access to affordable, reliable, sustainable and modern energy
- Promote sustained, inclusive and sustainable economic growth, employment and decent work
- Build resilient infrastructure, have industrialisation and foster innovation
- Reduce inequality within and among countries
- Make cities and human settlements inclusive, safe and sustainable
- Ensure sustainable consumption and production patterns
- Take urgent action to combat climate change and its impacts
- Conserve and sustainably use oceans…
- Protect terrestrial ecosystems, forests and halt land degradation and biodiversity loss
- Promote peaceful and inclusive societies, provide justice and build effective institutions
- Strengthen global partnership for sustainable development

18.2 Measuring development

- Economic growth —> the increases in output and incomes over time
- Economic development —> process that leads to improved standards of living for a population
- Human development —> Goulet —> life sustenance —> access to basic services
  —> self-esteem —> the feeling of self-respect
  —> freedom —> freedom from want, ignorance and squalor

Indicators:

- A measurable variable that indicates the state or level of something being measured
- Useful for —> monitoring how a country changes
  —> making comparisons between countries
  —> assessing how well a country is performing with respect to particular goals of dev.
  —> devising appropriate policy measures to deal with specific problems

Single indicators:

GDP per capita and GNI per capita:

- GNI per capita is a better indicator of the standards of living of a country —> it represents income per person received by the residents
- GDP per capita is a better indicator of the level of output per person produced in a country
- Must consider in terms of PPP in order to be correct across countries —> published by Organisation for Economic Cooperation and Development, European Union and World bank

Health indicators:

- Life expectancy at birth —> average number of year of life in a population
- Infant mortality —> number of infant deaths from the time of birth until the age one x1000
- Maternal mortality —> the number of women who die per year for pregnancy x 100000
- Influence by —> public health services and prevention of communicable diseases
  —> adequate health care services with access
  —> healthy environment (safe water, sanitation and pollution)
  —> adequate diet and avoidance of malnutrition
  —> high level of education of the entire population
  —> absence of serious income inequalities and poverty

Education indicators:

- Adult literacy rate —> the percentage of people aged 15 or more who can read and write
- Primary school enrolment —> the percentage of school-age children enrolled in primary school
- Lower secondary school enrolment —> same as primary
- Can be achieved also with low per capita incomes

Economic inequality indicators:

- Lorenz curve, Gini coefficients, poverty lines, minimum income, Multidimensional poverty index

Social inequality indicators:

- Adolescent fertility rates, prevalence of undernourishment, inequality in life expectancy, education, gender, child malnutrition, infants lacking immunisation, child labour, homeless people due to natural disaster, birth registration

Energy indicators:

- Social —> share of households without electricity and income spent on fuel and electricity
- Economic —> energy use per capita and share of renewable energy
- Environmental —> air pollutant emissions from energy systems and deforestation for energy

Environmental indicators:

- CO_2 emissions per unit of GDP and emissions of hazardous substances
- Bird and fish species threatened
- Ozone layer depletion
- Waste generation + waste water treatment
- Intensity of water use

Composite indicators:

Human development index by UNDP:
- Measures average achievement in —> long and healthy life
  —> access to knowledge
  —> decent standard of living
- Useful to government wishing to devise policies focusing on economic and human dev. —> superior to single indicators as a measure of dev.
- Does not provide info. about income distribution, malnutrition, demographic trends…

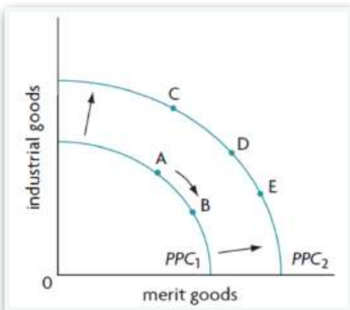
Inequality-adjusted HDI:
- Measures human dev. in the same three dimensions as the HDI, but each adjusted for inequality
- Attempts to measure losses in human dev. that arise from inequality

Gender inequality index:
- Measures inequalities between the genders in three dimensions:
  —> reproductive health —> maternal mortality and adolescent birth rate
  —> empowerment —> share of woman parliamentary seats and educated women proportion
  —> labour market participation —> proportion of women in the labour force

Happy planet index:
- Proposed as a measure of sustainable well-being adjusted for inequalities + ecological footprint
- Takes into consideration life expectancy, people's feeling about personal well-being

Strengths and limitations:
- Advantage —> useful as measures of different aspects of development
- Disadvantage —> based on statistical information
  —> some countries have a limited capacity to collect statistical data
  —> data are not fully available in many countries
  —> when data are not available agencies try to come up with estimates
  —> often agencies do not have access to recent data, incorrect comparison
  —> definitions of variables and methods vary from country to country

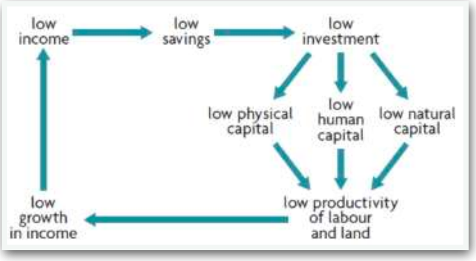
Economic growth and development:
- Economic growth can occur without economic development
- A —> B no economic growth with some development
- B —> C economic growth with no development
- B —> D or E economic growth with development



Chapter 19: Barriers to economic growth and economic development

19.1 Poverty cycles (or traps)

- Poverty is transmitted from generation to generation because:
  —> cannot afford to send their children to school
  —> cannot afford the necessary medical care and food —> physically disadvantaged
  —> large families —> income stretched to cover more people needs
- Banks do not lend to poor people —> no collateral
- To break cycle —> requires intervention of the gov.
  —> investments in capital (uses gov. revenues)
  —> foreign aid can help



19.1 Poverty cycles (or traps)

Economic inequality:

- Highly unequal distribution of income are a barrier to growth and development —> greater equality in income distribution may lead to more rapid growth and more development
- Asian Tigers —> Singapore, … adopted this strategy successfully
- In past it was thought of the opposite case instead
- Global trends show that inequalities in wealth are worsening in most developing countries

Infrastructure:

- Type of physical capital (roads, dams, power, telecommunications, …)
- Important for the effective functioning of any economy
- 20% of total investment in most developing countries —> mostly a government responsibility
- Developing countries perform poorly in it because:
  —> problems in financing
  —> inadequate maintenance + quality
  —> limited access by the poor
  —> misallocation of resources —> not enough demand for their services
  —> neglect of the environment

Access to technology:

- New technology contributes to improving the quality of physical capital
- Appropriate tech. —> satisfies economic, geographical, ecological and climate conditions
- Labour-using tech. —> uses more labour in relation to capital —> results in local employment and use of local skills and materials
- Capital-using tech. —> uses more capital in relation to labour —> in developing countries with large supplies of labour they displace workers and increase unemployment —> throw people into poverty and require skill levels + use of foreign exchange for imports
- Most tech. advances tend to be of the capital-using type
- Many of the technologies are inappropriate to the climates … of many developing countries
- Low R&D in developing countries —> no appropriate tech. produced

Human capital:

- Skills, abilities and knowledge acquire by people + good levels of health —> more productive
- Low levels of educational attainment and health in developing countries
- Barriers to education:

—> insufficient funding for education
—> insufficient teacher or untrained teachers
—> insufficient classrooms and basic facilities
—> lack of teaching materials
—> children with disabilities are excluded
—> gender discrimination
—> conflict or risk of conflict
—> distance of school from home
—> hunger and malnutrition
—> inability to pay for education

- Barriers to good health:

—> Insufficient funding for health care
—> insufficient access to health care services
—> private payments for health care
—> geographical access
—> insufficient numbers of trained medics
—> insufficient medical facilities and supplies
—> acceptability of modern medical practices
—> access to clean water + sanitation

Primary sector:

- Developing countries, especially the lower income ones, tend to specialise in the production of only a few goods, which usually are primary commodities
- Volatility of primary product prices has serious negative consequences for producers
- Consequences on efforts to plan for growth and development —> unable to determine future

International markets limited access:

- Tariff barriers —> products of interest to developing countries have high tariff barriers
  —> discourage the development of manufacturing and vertical diversification
  —> low tariffs on raw materials / higher tariffs on processed products (escalation)
- Non-tariff barriers —> administrative barriers
- Agricultural trade and rich country subsidies effects —>

—> Global misallocation of resources
—> Global inefficiency
—> Lower export earning for dev. countries
—> Increased poverty among affected people

The informal economy:

- Economic activities that are unregistered and legally unregulated
- International Labour Organization (ILO) —> work in the informal economy of developing countries is not undertaken to avoid payment of taxes or bypass labour as in developed countries
- Is necessary in the absence of other means of livelihood
- 61.2% of global employment is in the informal economy
- Correlated to the Human Development Index —> low HDI, high informal economy

Capital flight:

- Refers to the large-scale transfer of privately-owned financial capital to another country
- Caused by anything that may lead to the loss of value of the domestic current, the fear of loss of property through confiscation, increases in taxation, political instability, foreign debt problems, devaluation possibilities and balance of payments problems
- Involves a loss of financial capital that could have been invested domestically
- Forces governments to devalue the currency —> self-fulfilling prophesy
- Argentina's 61% and Mexico's 64% foreign debt accumulation was due to capital flight

Indebtedness:

- In 1973-1974 the Organization of the Petroleum Exporting Countries increased price of oil —> firms faced larger import expenditures and borrowed to cover their deficits
- In 1996 the World Bank began the Heavily Indebted Poor Countries (HIPC) Initiative —> provided debt relief to some highly indebted poor countries by cancelling $100 billion of it
- Debt situation has again deteriorated because of:

—> the global financial crisis in 2008
—> drop in global commodity prices in 2014
—> interest rates dropped to low levels —> easier to borrow for African countries
—> lower saving and large financing needs
—> poor governance
—> exchange rate depreciation —> value of debt increased
—> borrowing spent rather than invested
—> increase in borrowing from private sources

- Effects were:

—> debt servicing costs
—> poor credit ratings
—> increases in taxes and cut in gov. spending
—> increased income inequality
—> lower private investment as uncertainty
—> debt trap —> borrowing to pay debt
—> lower economic growth

Geography and landlocked countries:

- Transportation by sea is less expensive than by land
- Landlocked developing countries are disadvantages as export and import activities depend on their neighbouring countries —> may have poor relations, …
- Vienna programme of action aims to assist these countries

Tropical climates:

- Climate differences are key in determining types and methods of agricultural production, animal husbandry and labour productivity
- Developed countries have temperate climates, while developing countries have tropical climates

19.3 Political and social barriers

Weak institutional framework:

- Institution are rules organisations and social norms that facilitate coordination of human action
- Countries need to develop institutions relating to property rights, a well-functioning legal system, a transparent tax system, banking and credit institutions, protection against corruption + justice
- Justice is necessary to eliminate poverty as most is as a result of disempowerment and exclusion
- Developing country tax system features:

—> high dependance on indirect taxation
—> inefficient /highly bureaucratic tax systems
—> weak tax collection systems
—> political and economic power to wealthy

- Low levels of revenue —> the higher the level of GDP per capita, the higher the tax revenues as a share of GDP
  —> corruption in tax collection
  —> inefficiencies in tax collection
  —> tax exemptions and privileges of wealthy people
  —> low property tax rates
  —> elite influence government tax policies
- Inequities in tax systems —> not particularly progressive due to rely on indirect taxation
  —> very high income groups end up paying far less overall taxes

Banking:

- Banking services and access to credit are important to economic growth and development
- Lack of wealth typically means lack of access to credit
- Provides an incentive for people to save
- Provides businesses and farmers with credit
- Provides consumers with credit
- Access to credit is important for poverty alleviation

Property rights and land rights:

- Property rights —> laws and regulations that define rights to ownership, use, transfer of property
- The more secure the property rights (titling), the faster the economic growth
- Less investment when property rights are not secure + when borrowing property can be collateral
- Land rights —> the rights and rules to possess, occupy and use land

Land titling didn't work because:

- Titles were often capture by elites
- Once titles are established taxes may be imposed
- Land as collateral for poor and may lose it
- Economic hardship may force to sell
- Titling increases the market value of land

- Land grabs —> the buying or leasing of large pieces of lan by individuals and companies

—> can cause the risk of eviction and displacement of millions of poor farmers
—> food security is less as produced commodities are for export now

Gender inequality:

- Result in serious deprivations and limited access of women and girls to social, economic and political opportunities compared with men and boys
- Health and education are affected
- Labour market —> lower levels of education and skills disadvantage women as less qualification
- Inheritance rights and property rights —> in developing countries passed mainly to men
- Income, wealth and poverty —> women's income are on average substantially lower than men's

Appropriate governance:

- Better governance is related to more investment and greater economic growth
- Participation
- Decency
- Transparency
- Fairness
- Accountability
- Efficiency

Corruption:

- The abuse of public office for private gain
- Especially pronounced in countries where the legal system and mass media are weak
- Monitored by the Transparency International (TI)

—> tax to obtain something
—> bribes to be paid to obtain basic services
—> bribes going into the pockets of politicians
—> damages the people's trust in the state
—> misallocation of resources due to officials accepting bribes to pursue uneconomic projects / to bypass environmental regulations
—> restricts entry of new firms (competition)

Unequal political power and status:

- Difficult to carry out a dev. programme without the support of political elites —> poses difficulties for government undertaking policies
- Caste system —> social position determined by birth and cannot be changed
- Class system —> determined by factor over which there's is some control
- Race and ethnicity —> sometimes lead to prejudice, discrimination, intolerance and conflicts
- Political stability —> necessary for effective government decision making
  —> instability creates an environment of uncertainty
  —> instability often leads to an outflow of financial capital
  —> instability increases vulnerability to hunger —> resources to army
  —> *low levels of income per capita are associated with political instability*

Chapter 20: Strategies to promote economy growth and development

20.1 International trade strategies

Import substitution:

- A growth and trade strategy where a country begins to manufacture simple consumer goods for the domestic market to promote its domestic industry —> using protective measures
- Justified by the infant industry argument
- Latin American countries from the 1930s —> abandoned for export promotion in the 1980s
- Now only selective import substitution

Policies and consequences:

- High levels of protection of domestic firms —> inefficiency and resource misallocation
- Overvalued exchange rates —> capital-intensive production and unemp. + informal economy
- Too much government intervention in the economy —> inefficiency and resource misallocation
- Neglecting of agriculture —> more need for food imports
- Deterioration in the balance of payments —> imports of capital equipment and food + outflow of financial capital
- More capital-intensive production methods —> unemployment and income distribution worse
- Limited possibilities for growth over the long term

Export substitution:

- Strategy where a country attempts to achieve economic growth by expanding exports
- Asian tigers adopted it —> Singapore, China, Japan, …
- Included —> financial assistance to targeted key industries —> export industries and R&D
  —> strong government intervention —> state ownership of financial institutions
  —> large public investments in key areas
  —> requirements imposed on multinational corporations
  —> exchange rate management —> undervalued currencies to encourage exports
- Successful because —> expansion into foreign markets
  —> emphasis on diversification
  —> major investments in human capital
  —> increased employment
  —> appropriate technologies —> involving R&D
  —> no balance of payments problems
- Disadvantages —> overly dependent on exports —> recession can be dangerous
  —> may be efforts to maintain low wages to make exports more competitive
  —> possible trade deficits in trading partners —> could lead to trade protection

Regional free trade agreements:

- Will lead to increased growth and more development —> Latin America, Central America, …
- Help developing countries achieve growth and development when they involve:

—> regional agreements
—> geographical closeness
—> similar development
—> similar market sizes

Bilateral free trade agreements:

- Have the potential to provide a developing country with access to the developed country market
- UNCTAD —> BFTA threatens existing regional cooperation agreements of developing countries
- Need —> developing country must make equal and matching cuts in tariff and other barriers
  —> increases in exports are limited
  —> more imports and less propor. exports —> balance of payments problem, foreign debt
  —> developing countries have weaker bargaining power
  —> developing country must agree to other requirements —> may not be of interest
  —> weaken regional trade agreements when member country with a third country

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20.2 Diversification and social enterprise:

- Diversification —> reallocation of resources into new activities that broaden the range of goods and services produced —> primary sector share of GDP shrinks —> replaced by manufacturing
  —> characteristically of higher income developing countries
- Benefits: —> sustained increases in exports
  —> development of technological capabilities and skills
  —> reduced vulnerability to short-term price volatility
  —> use of domestic primary commodities
- Adding value to products is important because:

—> more varied production activities
—> employment opportunities
—> new firms to manufacture goods
—> higher skill and tech. levels created

- Overspecialisation —> in resource-rich countries —> become heavily dependent on primary commodities which have short-term volatility of export revenues —> balance of P difficulties
  —> resource-poor countries —> more labour-intensive manufacturing
- Social enterprise —> type of commercial organisation —> aims to achieve social goals to improve people's well-being and promote social change
  —> non-for-profit —> objective is to achieve their social goals not increase profit
  —> profits go back into the enterprise

20.3 Market-based policies

Washington Consensus:

- Washington Consensus —> free market approach to growth and development
  —> shared by World Bank, IMF and United States Congress
- Included —> trade liberalisation, privatisation of state enterprises and deregulation
  —> non exchange rate management, reduced restrictions to foreign direct investments
  —> limited borrowing by the government, restricting the use of industrial policies
- Effects —> limited benefits for export growth and diversification —> lost share in world exports
  —> limited effects on economic growth
  —> increasing income inequalities and poverty within developing countries (lower 40%)

Worse off —> —> —> less educated or illiterate people / —> poor people lack collateral
—> people in remote areas / —> people without exports
—> people in agriculture which now have volatile prices
—> people who lose their jobs due to cutbacks in the public sector
—> people affected by cuts on merit goods
—> people affected by lower levels of social protection (supply-side policies)
—> people forced into the informal economy

New consensus:

- Since late 1990s —> mix of markets with government intervention to support growth and dev.
- Governments support education, health, infrastructure and R&D
- Large budget deficits should be avoided —> does not involve reduction in the above
- Pursue policies that promote income equality and alleviation of poverty
- Provide a proper regulatory framework for markets to work effectively —> for competition, …
- Efforts to promote property and land rights, an effective tax system and banking
- Increase in foreign aid and access to markets from developing countries
- Developing countries should have a special treatment by the international trade agreements
- Help create the conditions for markets and trade to work to advantage developing countries

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20.4 Interventionist policies: redistribution + merit goods

Redistribution policies:

- Reduce inequality within and among countries —> objective of redistribution policies

Tax policies:

- Important that developing countries undertake reforms that will improve their taxation system
- IMF recommends —> increase in the progressively of the tax system
  —> expand the coverage of personal income taxes
  —> expand use of indirect taxes on luxury goods and on negative externalities
  —> increase taxation from capital income (profits)
  —> impose or increase taxes on real estate and land
  —> reduce tax evasion

Transfer payments:

- Universal social protection —> access by an entire population to social protection —> costly
  —> child benefits, pensions, disability, unemployment, …
- Transfer payments —> cash transfers or benefits in kind

—> reduce poverty and increase inclusion
—> empowers individuals
—> increases incomes
—> promotes economic growth (AD)
—> safety against sudden hardships
—> improves access to health care + education
—> reduces malnutrition and child mortality
—> introduces the poor in the formal economy
—> reduces child labour
—> political stability
—> do not reduce the incentive to work

- Conditional cash transfers —> money paid on condition that the households undertake activities related to education and health care
- Non-conditional cash transfers —> do not impose restrictions

Minimum wages:

- To support incomes of unskilled workers —> gives rise to unemployment
- Job losses do not occur unless minimum wages are set at very high levels
- Reduces income inequalities
- International Policy Centre for Inclusive Growth (IPC-IG):
  —> should be set after consulting with representatives of workers
  —> should consider the needs of workers and their families
  —> must ensure compliance and enforcement

Provision of merit goods:

- Merit goods are important for growth and development
- *Positive externalities of education:*

—> Economic growth (more productive)
—> more physical capital quality (education)
—> increased political stability
—> lower crime rate and better life quality

- *Positive externalities of health care:*

—> greater work productivity
—> no disease transmission

Combined benefits:

—> education of woman —> improved maternal health and less maternal mortality

—> healthier children due to better nutrition

—> basic principles of hygiene and sanitation

—> better health improves school attendance

—> longer lifespan to use skills learned

Services must be:

—> universal

—> free

—> public

—> promote women

Infrastructure:

- Increases productivity and lower costs of production
- Facilitates modernisation and diversification of the economy
- Quantity and quality of infrastructure —> determine shipping costs
- Provides services essential for a basic standard of living

20.5 Foreign direct investment and MNCs

Multinational corporations:

- FDI —> investment by first based in one country in productive activities in another country
  —> control of at least 10% of the firm in the host country
  —> a firm taking FDI is called multinational corporation
- MNC —> mainly in developed countries in 20th century —> form 1980s also developing (50%)
  —> produce 33% of global output and half of world exports and imports
- *MNCs go in developing countries because:*

—> increases sales and revenues

—> bypass trade barriers

—> lower costs of production

—> use locally produced raw materials

- *MNCs search for:*

—> political stability

—> stable macroeconomic environment

—> favourable tax rules

—> weak labour protection laws

—> a liberalised economy and large markets

—> trade policy emphasising exports

—> rapid economic growth

—> well-function infrastructure

—> a well-educated labour force

- Advantages: —> MNCs can supplement insufficient foreign exchange earnings
  —> can improve local technical and management skills
  —> can supplement insufficient domestic saving and increase investment
  —> can lead to greater tax revenues in the host country
  —> can help promote local industry
  —> can increase local employment and higher economic growth

- Disadvantages —> may not always supplement insufficient foreign exchange earnings
  —> may not always improve local technical and management skills
  —> may not lead to greater tax revenues in the host country
  —> may not help promote local industry
  —> may not help lower unemployment in the host country
  —> environmental degradation
  —> promote inappropriate consumption patterns in developing countries
  —> may use government funds to build not needed infrastructure
  —> may use their economic + political power for policies that decrease growth
  —> competition between developing countries to host MNCs —> degrades them

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20.6 Foreign aid:

- The transfer of funds or goods and services to developing countries
- Objective —> to bring about improvements in their economic, social and political conditions
- 2 types —> concessional —> aid may involve grants
  —> non-commercial —>. Must not involve buying and selling or profit

Humanitarian aid:
- In regions where there are emergencies caused by violent conflicts or natural disasters
- Intended to save lives, ensure access to basic necessities and to assist in reconstruction
- Through grants or goods-in-kind (food, …)

Development aid:
- To help developing countries achieve their economic growth and development objectives
- May involve financial support for specific projects, to sector or technical assistance
- Are offered by ODA and NGOs

Official Development Assistance (ODA):

- Comes from government funds —> forms the largest part of foreign aid
- Three ways —> through bilateral aid —> funds go directly
  —> through multilateral aid —> funds go directly but from many countries
  —> through NGOs —> spend them in developing countries
- Provided because —> political and strategic motives
  —> economic motives
  —> humanitarian and moral motives

Private aid: Non-governmental Organisations:

- Second type of aid flowing into developing countries
- Are not party of any governmental structure
- Charitable organisations, non-profit organisations and nationally based groups
- Obtain their funds from private voluntary contributions and ODA funds
- Can perform functions that are not performed as effectively by national governance

Evaluating foreign aid:

- Countries can escape the poverty cycle if foreign aid provides the missing funds for these investments
- Aid can make resources available for investments in health, education, … —> helps poor people
- Contributes to improved income distribution
- Leads to economic growth
- Debt relief helps countries reduce their debt

Limits of ODA:

- Tied aid —> recipients forced to spend a portion of funds to buy goods and services of donor
  —> recipients cannot seek lower price and buy inappropriate capital-intensive tech.
  —> large firms in developed countries usually benefit from this
- Conditional aid —> recipient forced to pursue policies to achieve a greater market orientation
  —> recipient forced to accept particular projects that the donors decide on
- Aid volatility —> chaining volumes of aid in donor budgets —> difficult to implement policies
  —> governments cannot predict the future aid
- Uncoordinated donors —> aid-funded projects are many and un-coordinated and may overlap
- Substitution —> recipient government may use funds to substitute for domestic resources (taxes)
- May not reach the most in need
- Corruption
- Quantity of aid —> ODA funds are far less than the target amount

Advantages of NGOs:

- Strong anti-poverty orientation of activities
- Working closely with project beneficiaries
- Contribute to democratisation, advocacy and raising public awareness and support
- Offer expertise and advice
- Able to innovate in pursuit of solutions
- Enjoy the trust of beneficiaries

Criticisms to NGOs:

- Small size and weakness of many NGOs
- Possible loss of independence due to growing dependence on governments for funding
- May attract the best qualified personnel away from government
- Challenge to state authority —> must not be considered a replacement of government

Debt relief:

- Multilateral Debt Relief Initiative —> 100% debt relief for debts by the World Bank and IMF
- Heavily Indebted Poor Countries Initiative came before
- Countries had to —> have a GNI per capita below a certain level
  —> have a debt level that cannot be sustained
  —> show evidence that they are following WB and IMF policies
  —> have to commit themselves to pursuing a poverty reduction strategy
- Problems —> some bilateral creditors did not provide any relief
  —> programme takes effect too slowly
  —> some measures are too severe to follow
  —> many countries are highly indebted but have not been included

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20.7 Multilateral development assistance

- Involves lending to developing countries on non-concessional terms
- Rates of interest and repayment periods are determined by the market
- Lenders are —> multilateral development banks —> World Bank, Asian Dev. Bank, …
  —> the International Monetary Fund
- Lending for economic development or international financial stability —> not for commercial

World Bank:

- Development assistance organisation that extends long-term loan to developing country governments for the purpose of promoting economic development and structural change
- Formed in 1944 and has 189 member states
- Is a lender of funds to governments
- Two organisations —> International Bank of Reconstruction and Development (IBDR)
  —> non-concessional terms to middle income developing countries
  —> International Development Association (IDA)
  —> loans to low income countries on highly concessional terms
- Structural adjustment loans —> in past used to change the course of policy-making in developing countries by reducing government intervention and promoting competition —> strong criticism

- Current goals —> has committed to Sustainable Development Goals —> before was millenium
  —> poverty-oriented projects and require gov. intervention, access to credit by the poor, reforms for more equitable distribution, reverse environmental degradation

Evaluating the WB:

- Social and environmental concerns —> ensure that project objectives are consistent with SDGs
- World Bank governance dominated by rich countries —> voting power on financial contribution
- Excessive interference inn countries' domestic affairs
- Conditional assistance (lending) —> deprives countries of control
- Inadequate attention to poverty alleviation —> not doing enough
- Evaluating focus on market-based supply-side policies —> criticised for focusing on increasing flexibility in labour markets

International Monetary Fund:

- A multilateral financial institution that was established jointly with the World Bank
- Purpose —> lending to countries with balance of payments deficits
- Has 189 member countries and oversees the global financial system, follow macroeconomic policies of members, stabilising exchange rates and help countries with payment difficulties
- The loans provided usually come with a package of stabilisation policies that must be followed
- IMF may be rethinking its policies
- Activities —> contractionary monetary policies —> help with the balance of payments position
  —> contractionary fiscal policies —> to lower AD
  —> currency devaluation or depreciation
  —> cuts in real wages
  —> liberalisation policies —> to promote a free market and environment
- Criticisms —> IMF governance governance dominated by rich countries
  —> excessive interference in countries' domestic affairs
  —> conditional lending
  —> damaging effects on developing countries
  —> IMF stabilisation policies based on a flawed concept

20.8 Institutional change

Microfinance:

- Items that all men and women —> particularly the poor and vulnerable should have equal access
- Refers to credit (loans) in small amount to people who do not ordinarily have access to credit
- Short repayment periods involved

- Are delivered by Microfinance institutions —> credit unions, NGOs, informal savings, …
- Appeared in the 1970s and revealed that the poor were capable of excellent repayment rates
- Have a positive impact on poverty reduction
- Only reach only a very small proportion of poor —> not enough microcredit schemes
- Controversies —> microcredit schemes may become a substitute for anti-poverty policies
  —> microcredit schemes contribute to the growth of the informal economy
  —> interest rates in micro credit schemes are too high

Mobile banking:

- The use of mobile telephones to receive or send money and to pay bills
- Advantage included are:

—> payments with instant access + no delays
—> no need for travel with cash
—> reduced costs and easier to pay workers
—> easier to get loans, insurance, …
—> easier payments with no need to travel
—> easier for poor people

- Disadvantages —> network problems cause delays, cost of the service, fraud chances

Women's empowerment:

- Improvements in child health and nutrition and lower child mortality
- Improvements in educational attainment of children
- Quality of human resources
- Lower fertility (lower birth rates)
- Reached through:

—> equal participation and representation
—> promoting education + skill development
—> eliminating violence and discrimination
—> making pregnancy and work possible

Reducing corruption:

- Develop high levels of transparency and independent external scrutiny —> provide supervision
- Reform institutions of tax administration
- Build professional civil service based on merit hiring
- Focus on areas where there is a higher risk
- Cooperate with other countries to make corruption more difficult to take place across boarders
- World bank —> establish institutions and incentives to prevent corruption
  —> mechanisms that discourage corruption —> penalties and sanction
  —> development of the type of government needed

Property and land rights:

- Contribute to food security —> improve access to credit and productivity of small farmers
- Lead to lower rates of deforestation
- Preserve diverse food cultures + biodiversity

- Support indigenous peoples
- Contribute to gender equality if to women
- Contribute to poverty reduction

20.9 Strengths and limitations of government intervention vs market-orientation

Market-oriented policies:

- Market-based supply-side policies —> encourage competition, labour reforms, incentive policies
- Trade liberalisation
- Freely floating exchange rates
- Strengths —> result in greater efficiency in production, lower prices and improved quality, better allocation of resources, economic growth and economic well-being
    —> incentives to work, innovate and invest
    —> markets much larger than they would be with trade barriers
- Weaknesses —> market failure —> environment, merit goods and public goods provision
    —> weak institutional framework —> cannot improve institutions
    —> income inequalities and poverty
    —> inability to alleviate poverty
    —> inability to empower women
    —> informal economy
    —> questionable effect on economic growth and development

Interventionist policies:

- Based on government intervention in markets intended to correct market deficiencies and create an environment in which markets can work more effectively
- Strengths —> correcting market failures
    —> investment in human capital
    —> provision of infrastructure
    —> dev. of stronger institutions
    —> redistribution of income
    —> promotion of gender equality
    —> industrial policies
    —> provision of stable macro env.

- Weaknesses —> budget funds
    —> excessive bureaucracy + inefficiency
    —> possible protection of inefficient producers
    —> excessive intervention leads to allocative inefficiencies
    —> possible influence of elite groups exerting political pressures
    —> corruption
    —> poor governance
