A Level Economics (EdExcel)
Theme 4: A Global Perspective

Course companion 8:
Strategies influencing growth and development 2022-23




Teacher:

Student Name: ________________________

Strategies influencing growth and development

Economists differ about the most effective development strategies for any particular country:

- Free market economists tend to advocate **market-orientated strategies**, which rely upon **market forces** to deliver development.
- Interventionist economists advocate **interventionist strategies**, where the **government plays a leading role**, regulating and manipulating markets or bypassing markets through direct provision of goods and services.

Some of the strategies in the specification have already been discussed in previous course companions (see below), the remainder will be discussed in this course companion.

Specification
4.3.3 Strategies influencing growth and development

a) Market-orientated strategies:
- Trade liberalisation Page 5
- Promotion of FDI Page 6
- Removal of government subsidies Page 8
- Microfinance schemes: Page 9
- Floating exchange rate systems: Page 3
- Privatisation Page 3

b) Interventionist strategies:
- Development of human capital: Page 4
- Protectionism: Page 3
- Managed exchange rate Page 3
- Infrastructure development: Page 4
- Promoting joint ventures with global companies Page 14
- Buffer stock schemes Page 15

c) Other strategies:
- Industrialisation: The Lewis model Page 18
- Development of tourism Page 21
- Development of primary industries Page 24
- Fairtrade schemes Page 25
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d) Awareness of the role of international institutions and non-government organisations (NGOs):
- World Bank Page 33
- International Monetary Fund (IMF) Page 35
- NGOs Page 41

Review of previously covered market-orientated strategies influencing growth and development:

Floating exchange rates

How will the policy promote development?	*Evaluation*
Exchange rates adjust to restore competitiveness. If an economy is uncompetitive the currency will depreciate. This will reduce export prices and increase import prices and increase competitiveness. *If a government fixes the exchange rate at a high rate it may have to use high interest rates or it may need to keep large reserves of foreign currency or it may need to impose capital controls.*	*If the exchange rate is very volatile this could cause uncertainty about the cost of imports, the revenue from exports and the return on FDI. This could deter international trade and FDI.* *Fixing the currency at a low rate increases exports and increases AD, economic growth and employment (eg in China)*

	Fixing the currency at a high rate reduces the price of imports and cost-push inflation. This raises living standards

Privatisation

How will the policy promote development?	*Evaluation*
Governments can raise revenue by selling shares to private individuals. Also, they don't need to subsidise loss making state sector companies *Privatisation may enable governments to introduce more competition in markets and increase contestability. This could increase efficiency and choice* *Private sector companies have an incentive to maximise profits. This encourages them to cut costs, invest and innovate. Private sector companies may be more dynamically efficient and provide better quality goods and services for consumers* *Private sector companies may provide goods and services that consumers want. Nationalised industries may not do this and could be allocatively inefficient*	*Privatisation may create privately owned monopolies which may exploit consumers with high prices and poor quality services. It is sometimes difficult to regulate these firms due to assymetric information and regulatory capture.* *Privatisation may result in greater inequality as the profits from private sector firms go to wealthy owners or shareholders instead of to the government. Private sector firms have more unequal pay structures than nationalised industries. Top managers may earn a lot more than in the public sector, but low skilled workers may have poorer pay and working conditions.* *Privatisation may result in fragmentation of services. For example there may not be an integrated transport system where trains and buses link up with each other.*

Protectionism

You could make the opposite points to trade liberalisation (see above)

Managed Exchange rates

You could make the opposite points to floating exchange rates (see above)

Review of previously covered interventionist strategies influencing growth and development:

Development of human capital

How will the policy promote development?	*Evaluation*
If workers have better skills this could increase productivity, AS and economic growth *Countries that have invested in education have seen rapid economic growth and development.* *FDI may be attracted and Multi National Companies MNCs may wish to employ skilled workers.*	*There may be long time lags. It would take many years before improvements to primary school education would benefit an economy* *Developing countries may experience a brain drain where skilled workers chose to emigrate* *Children may not attend school if they come from poor families who need them to go out and work*

A well-educated population may be more politically aware and could put pressure on politicians to ensure there is good governance and better economic decisions are made	*The quality of the education system is poor in many developing countries*

Infrastructure development

How will the policy promote development?	*Evaluation*
Investment in infrastructure such as roads, railways, power stations and water supplies, schools and hospitals can provide essential services and reduce extreme poverty. *Infrastructure may help to increase productivity and increase AS and long term economic growth. It can increase international competitiveness and exports and improve the current account of the balance of payments*	*Infrastructure is very expensive to build and there is a high opportunity cost for developing countries.* *Sometimes infrastructure is built which does not increase growth and development. For example, governments may build motorways, conference centres and stadiums that do not help the poor and do not promote growth and development*

Market-orientated strategies influencing growth and development:

i. Trade liberalisation

Relevant key terms

Globalisation: from an economic perspective, the ever-increasing integration of the world's local, regional and national economies into a single international market.

Trade liberalisation: the move towards greater free trade through the removal of protectionist barriers to trade.

Specialisation: a system of organisation where economic units such as households or nations are not self-sufficient but concentrate on producing certain goods and services and trading the surplus with others.

Economies of scale: a fall in the long run average costs of production as output rises.

Free trade: international trade conducted without the existence of barriers to trade, such as tariffs or quotas.

How can trade liberalisation promote growth and development?

Refer to concepts previously covered: Specialisation & Comparative Advantage; economies of scale (theme 3); efficiency; openness to FDI and free trade; export-led growth

Advantages of trade liberalisation as a way of promoting growth & development	Evaluation: Disadvantages, limitations, success depends on…
Explain how the following concepts could link to growth and development: Specialisation and comparative advantage Increased productivity. Economies of scale: internal as we scale up, develop infrastructure – external economics of scale Competition and efficiency – Innovation – dynamic efficiency, allocative efficiency. Lower prices – consumer surplus up Export led growth – X goes up, AD and economic growth up. Free trade and openness to FDI – Choice up, prices down.	**Explain the impact of the following on growth and development:** Domestic firms unable to compete with global competitors because lower labour costs, previous economies of scale. Infant industry – subsidies, tariffs – 5 years under WTO rules. Repatriation of profits means – big companies send profits back to developed countries. Tax. Joint venture. TNCs bringing own staff means – transfer payments, CEV – some expenditure in the country. Loss of tariff revenue will particularly impact – government spending, domestic firms, particularly in infant industries.

Use an AD/AS diagram to show impact of export-led growth on growth and development Draw tariff diagram to show impact of a fall in tariffs:	Impact on domestic producer surplus: Decreasing domestic producer surplus, structural unemployment.

ii. Promotion of Foreign Direct Investment (FDI)

FDI may be encouraged by a variety of measures, including, trade liberalisation, deregulation of capital markets, tax incentives and measures to make it easier and cheaper for global companies to build factories in developing countries

Relevant key terms

Foreign direct investment (FDI): inflows of capital spending by foreign firms, including takeovers of domestic businesses by foreign-owned businesses / investors, or investment undertaken in one country by companies based in other countries, e.g. Coca Cola setting up a plant in Nigeria to manufacture soft drinks.

Multinational company or transnational corporation (TNC): a company with significant product operations in at least two countries.

Transfer pricing: an accounting technique used by transnational corporations for reducing taxes on profits by selling goods at a low price internally from a high-tax country to another part of the company in a low-tax country.

How would the use of transfer pricing act as a restraint on growth and development?

Lower tax revenue for the government, therefore that limits growth and development. Opportunity cost – this can't be spent on infrastructure.

Draw an AS/AD model to show impact of FDI

Using an AS/AD model, show how inward investment from a TNC can affect the recipient country's growth, employment and inflation in the short run and long run:

FDI and the circular flow of income

Explain how inward investment would affect the circular flow of income of the recipient country:

FDI and the balance of payments

How will FDI impact the balance of payments (current and financial accounts)?

FDI recorded on the financial account. Net inflow in investment. AD will go up. Largely a one-off investment, eg: building a factory.

More investment will lead to more exports recorded on the current account. Increase in net trade. Could lead to an improvement in the current account.

FDI and the Harrod-Domar Model

Explain the benefits of FDI using the Harrod-Domar growth model (Harrod-Domar model covered in Summer 2018):

Investment leads to more savings and ultimately more growth as the savings ratio improves.

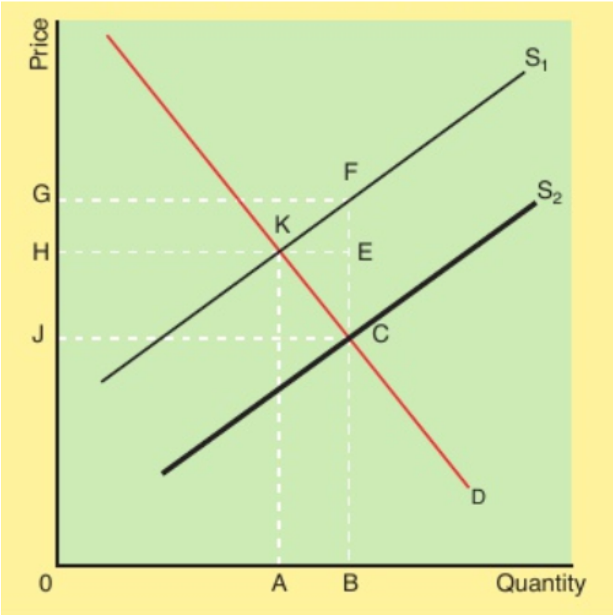
iii. Removal of government subsidies

Subsidy: A grant given which lowers the price of a good, usually designed to encourage production or consumption of a good.

Use of subsidies in developing countries:
- Often target essential goods such as food or fuel.
- May also subsidise agriculture and industry to increase output & investment

Theme 1 revision: The impact of a subsidy

1. The government giving a subsidy on a good will push the supply curve to the right from S1 to S2. Identify the following with reference to the diagram:



(a) The original equilibrium price

(b) The new equilibrium price

(c) Subsidy per unit received by consumers

(d) Subsidy per unit received by producers

(e) Total subsidy per unit

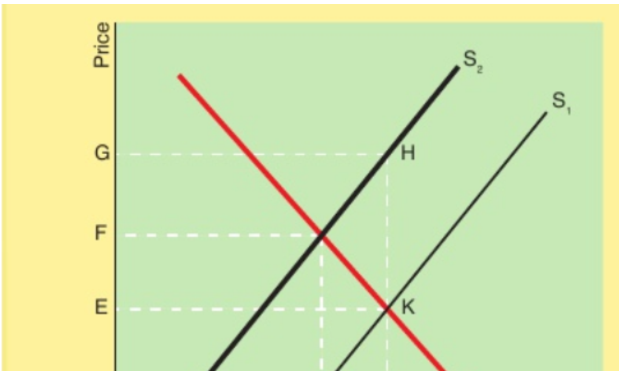
(f) Total subsidy received by consumers

(g) Total subsidy received by producers

(h) Total subsidy given by the government

Elasticities and subsidies

The more price inelastic is demand or price elastic supply, the more of a subsidy will benefit consumers rather than producers. Given a subsidy of HF per unit, HG per unit is received by consumers, but only GF by producers.



Removal of subsidies

2. With reference to the diagram, explain the impact of removing a subsidy on the price and quantity sold.

IV. Access to credit and banking including microfinance

In developed countries, individuals, firms and governments have access to financial systems allowing them to save, borrow, buy company shares, and take out insurance. In many developing countries such as Mozambique it is less likely individuals/businesses will have access to such institutions.

Micro finance is a means of providing extremely poor families with small loans (micro-credit) to help them engage in productive activities or grow their tiny businesses, e.g. Grameen Bank, Bangladesh.

Key features:

- Loans repaid with interest which covers the costs involved.
- Loans to people with limited alternative sources of finance.

Main clients:

- 97% women.
- Self-employed, often household based entrepreneurs.
- Small farmers in rural areas.
- Shop keepers, street vendors and service providers in urban areas.

Class work: In pairs/groups read the articles on micro finance and summarise country examples and analysis/evaluation to feed back to the group:

Small loans to women make big changes

By Clare Davidson , Business reporter, BBC News , August 2007

It all started when Joyce Wafukho, then in her early 30s, spotted a gap in the market in her village in Kenya. "There was no hardware store," explains Mary Ellen Iskenderian, who first visited Ms Wafukho after becoming head of the non-profit organisation Women's World Banking in September 2006. "After borrowing from family members and scraping some savings together, she started selling nails and screws from a kiosk." She also sold tomatoes, "not your standard DIY stock," laughs Ms Iskenderian. However, she needed more investment. "Try as she did, she couldn't get a bank loan for love or money," said Ms Iskenderian. But she heard about the Kenyan Women's Financial Trust (KWFT) and borrowed $70 (£35). The money revolutionised her business. In fact, it did more than that. The loan also improved the prospects of Joyce's three children considerably, enabled her sister to study for a doctorate and created local employment. Seven years later, Ms Fawukho employs more than 20 people in her hardware business, says Ms Iskenderian, visibly delighted in recounting Joyce's story.

The Women's World Bank has a network of microfinance institutions helping women on low incomes. Local organisations can provide support, advice, technology and even space to help nurture a project. Ms Iskenderian, who spent 17 years at the World Bank's International Finance Corporation (IFC) and has also worked for investment bank Lehman Brothers, talks about how enjoyable it is to meet the women who have secured loans. "What is exciting is you are making a real difference," she says.

The idea that providing a small amount of money can make a big difference is not new. But microfinance schemes have gained increasing interest, especially since Bangladeshi economist Muhammad Yunus and the Grameen Bank were jointly awarded the 2006 Nobel Peace Prize. Mr Yunus, who founded the bank in 1983, was a pioneer behind micro-credit lending to poor people, notably women in Bangladesh. "Traditional finance tends not to cater to women - either because the terms of the loans are not favourable or because they are such small fry that most individuals are not worth a bank's attention," explains Ms Iskenderian. Nowadays, microfinance loans are available in many other parts of the world, from Pakistan to the Philippines. They tend to be given to women, who make up the majority of the world's poor. Helping women in business activities - whether they want to open a hardware store, sell solar panels or buy livestock - is only part of the story.

It also gives them the chance to put money aside. "Saving is a huge problem," says Anton Simanowitz, a socio-economist at the Institute of Development Studies (IDS). Poor people can and do save at home, but this is often insecure. However, lending money that is then invested in a small business can create a source of income for the borrower and savings. "If people can save, they can reduce their vulnerability and plan a bit," adds Mr Simanowitz. One of the most striking aspects of these small loans is the reliability of the borrowers. Repayment rates in certain micro-credit organisations are about 95%. What distinguishes men and women when they borrow small amounts is how they choose to spend it, says Ms Iskenderian. When women are the recipients of microfinance loans, they spread the money around, so the children and the household tend to benefit more. Women tend to invest in three things: health, their children's education and the home, she says. Men, on the other hand, put more back into the business.

And it is not just in the developing world that microfinance has a use, says Paul Barry Walsh, founder of the UK-based Fredericks Foundation, which provides business loans to those who tend to be ignored by other lenders. These tend to be single parents, disabled or unemployed people - mainly women. "Microfinance is a very powerful tool that has been grossly underestimated," even in the developed world, says Mr Walsh. Microfinance is far from cohesive and questions remain about how effective it is as a long-term solution to poverty. Nonetheless, there has been a growing interest from larger investors who want to tap into this sector. But this has also raised concerns that the involvement from bigger players could detract from its social aims. Even investment bank Morgan Stanley has been getting involved in microfinance. "It could become the victim of its own success," warns Ms Iskenderian. Advocates are keen for the social goals of microfinance to be maintained. "Most people are not entrepreneurs. They are trying to generate income for their families," says Mr Simanowitz. "It is a financial means to an end."

Article1: Small loans to women make big changes
Country examples: Summarise how micro finance used in:
Kenya

UK

Then note advantages/disadvantages of micro finance in table below

Kenya's women spearheading micro finance projects

By Damian Reece, Telegraph, Mar 2011

Money is a female thing in Kenya. At least it is among the vast numbers of poor - rural and urban - who make up the majority of this country's 40m population. Micro finance schemes in Kenya are almost without exception dominated, run and organised by women who are far more effective in managing both family and village finances.

Of that number, only about 8m are considered in a position to open a bank account and the number of mortgages in the country runs into the thousands. Most employment and job creation lies outside the formal economy and with so many people working to simply scratch a living there seems little prospect of villagers even getting a toe hold on the climb towards stability, security and progress. But that's without taking account of the organisational powers of women in Kenyan life who, with a little help from non-governmental organisations, are accumulating financial resources and building levels of financial security hitherto unknown. "We wanted to empower ourselves. We knew we could do it on our own," says Rose Olouch about the circle of women gathered under the trees in a tiny settlement near the village of Kombewa about forty minutes drive from Kisumu, Kenya's third city which lies on the shores of Lake Victoria. She has been leading this group of about 20 women who have started a village association which provides them with a way to save, take out loans and contribute to a group insurance fund to cover emergencies.

Although about 25pc of adults taking part in these schemes across the country are now men, they are still almost without exception dominated, run and organised by women who are far more effective in managing both family and village finances and making decisions about what's best to spend money on to improve standards of living. "Before this group it was difficult to manage my business," says Eunice Owange. "I couldn't maintain my stock levels. The sales were low as a result so I couldn't feed my kids." After taking out a loan from her village association she's been able to invest more in her stock. "The business is doing better. Now I can feed my family." Rose Juma is doing even better having been able to buy three donkeys with a loan. She now runs a business earning her 500 Kenyan shillings a day (about £3.75p) transporting water in large yellow plastic drums from the local source, which is too far to walk for many people, back to her village. Alice Opiyo has been able to send her child to school thanks to the savings and loans group. Nigel Chapman, a former head of the BBC's World Service and now chief executive of Plan International, an organisation which supports micro finance initiatives, says: "No amount of aid will lift a rural economy out of its poverty. It may enable but it needs enterprise too." And that's what these savings and loans groups have done – provide villagers with a basic level of financing for their more ambitious activities. But the sums are tiny. The group meets monthly in a reverential gathering. A prayer opens and closes the meetings and an attendance register is taken. Silence is kept through out, anyone talking out of turn is fined 10 shillings. A large metal cash box is produced, secured with three different padlocks each one opened by a different key holder. Each member of the group has a number and is called out in turn. All transactions, deposits or loans, are announced out loud so everyone knows each others' business with each transaction noted in a member's pass book. The minimum deposit is 100 shillings, 300 shillings will elicit applause and ululation from the assembled group. Most months the total amount deposited will equate to the amount requested in loans (charged at 10pc interest repayable in full at the next month's meeting) which at this

group's meeting was about 7,000 shillings in total, or £52. This also means cash is put to work rather than lying idle in a box and helps keep it out of temptation's way too.
But while these groups, built on trust and providing people with valuable training in organisational skills, are making a difference they're not called micro-finance for nothing.

Article 2: Kenya's women spearheading micro finance projects
Country example: Kenya: Describe the use of micro-finance in Kenya

Then note advantages/disadvantages of micro finance in table below

Microfinance is under threat from greed - and it's the poor who are suffering
Summarised from: Louise Armstrong, Telegraph, June 2012

Microfinance, is the practice of lending as little as $20 (£13) to people with no source of financing. Now a $70bn global industry,it is attacked by Hugh Sinclair, in his book *Confessions of a Microfinance Heretic*, an explosive account of extraordinary financial greed and exploitation. Hugh Sinclair, its British author and microfinance veteran, claims that after a decade, he's discovered the sector isn't dominated by saints but has been "hijacked by profiteers". Rather than helping the world's poorest people set up their own businesses, the book says the funds are charging up to 200pc interest for a tiny loan and creaming off "eye-popping" returns. David Korten, the Harvard economist, says in the foreword to the book: "Sinclair spells out in detail, many micro credit programmes are nothing more than predatory lending schemes rebranded as socially responsible investment opportunities." He adds that the book is about "how a good idea was derailed by the same mindless pursuit of financial gain that caused the global financial crash of 2008". And yet again some of the world's financial powerhouses, including Deutsche Bank, Standard Chartered and Citibank, are among the beneficiaries.

The big banks are not accused of devising the interest rates or dubious lending policies of many of the microfinance initiatives (MFIs) on the ground, but they are blamed for fuelling the crisis and allegedly turning a blind eye to the problems. After collecting money from investors, the banks usually channel cash into MFIs directly, or via a third-party. Sinclair's claims suggest that – at the least – the institutions have failed to do proper due diligence on the schemes they are funding. He concedes it isn't always their fault: he describes the sector as opaque, secretive and hostile to those who ask questions. But he claims the banks have been slow to stop funding projects, even when they are told about dubious practises. "Which is worse – to invest in such an MFI with full knowledge or to admit investing without bothering to obtain full knowledge? Best left unanswered," he writes. The book is likely to send shockwaves far and wide. The sector has attracted such names as Microsoft founder Bill Gates, Pierre Omidyar, founder of eBay, and George Soros, the hedge fund investor. Celebrity supporters include Bono, the Clintons and the Queen of Spain.

The big names have been drawn by what Sinclair calls the "core values of entrepreneurial vision – of teaching a man to fish rather than handing him a fish on a plate". Yet, in the book, he says the quote should be rephrased: "Give a woman a microcredit loan to buy a fishing boat and the CEOs of the MFI and the microfinance funds will eat for a lifetime." Sinclair is careful not to condemn the whole industry. He insists there are funds that are faithful to the original ideals. But he says they are now the exception. The biggest problem, he argues, is that microfinance is successful for Western banks and investors because 200m people repay the loans and the steep interest rates, albeit by borrowing even more. He says the process is as illogical as claiming that the more credit cards are used, the better off a population must be.

“There is actually surprisingly little evidence supporting microfinance as a practical tool of poverty reduction,” he writes. “Microfinance does not apparently require evidence to prove it works. It works because the poor repay loans and this is all the proof the sector requires.”

The sector is comprised of three main parts: the ultimate capital providers (governments, pensioners, individuals and savers); the intermediaries, who channel the funds (the microfinance funds in developed countries and the MFIs in developing countries); and the poor, who receive the loans in developing countries. Sinclair says the biggest problems are with the intermediaries. He adds: “The MFI charges whatever rate of interest to the poor it can get away with, in unregulated markets with minimal client protection.” There is little effort to check what the loans are for. Instead, the cash is often taken and spent on a TV or repaying other loans. The loan often comes with hidden charges on top of hefty interest rates. “Interest rates under 30pc a year are disappointingly rare, and rates of 100pc or higher are common,” writes Sinclair. “One celebrated [microfinance initiative] in Mexico charges up to 195pc per year.” Even when the loan is used to start a business, they are usually too small to generate enough to support the payments. In recent weeks, the Indian parliament introduced The Micro Finance Institutions (Development and Regulation) Bill following anger about the collapse of the country’s only listed fund, SKS Microfinance. Shares in SKS, which lends to Indian women, have plunged from Rs1,021 (£11.70p) in October 2010 to around Rs65 (75p) today. The company raised $350m in its stockmarket listing but was badly damaged after politicians criticised the fund for aggressive collection tactics that allegedly drove some women to suicide.

Article 3: Micro-finance is under threat from greed – and it’s the poor who are suffering **Country example: India**: Describe problems with micro finance in India   Then note advantages/disadvantages of micro-finance in the table below

Analysis & evaluation: Note advantages & disadvantages of micro-finance from the 3 articles

Advantages: Micro-finance as a way of promoting growth & development	 Evaluation: disadvantages, limitations, what does success depend on?
• Harrod-Domar model: savings & investment important as they determine growth • Increase the number of economically active and self employed people in an economy. Can lead to a workforce being developed. • Multiplier effect. •	

b) Interventionist strategies
i. Promoting joint ventures with global companies

Joint Venture: a company that is owned by, usually, two major firms or a firm and a government.

To avoid some of the disadvantages of FDI, a government of a developing country may insist on a major project being set up as a joint venture, e.g. US Car Company wishing to set up car factory, may be asked to find a local partner to create a jointly owned company for the car plant, possibly 50:50 ownerships.

Jaguar Land Rover: China approves joint venture
BBC, 18/11/12
Jaguar Land Rover is to make vehicles in China for the first time after Beijing approved a £1bn joint venture. The West Midlands-based luxury carmaker agreed a "milestone" deal with Chery Automobile and will build a plant near Shanghai, which is due to open in 2015. JLR said any cars produced would be in addition to its existing output, and it had no intention of moving its manufacturing base out of Britain. Sales of JLR models in China have risen by 80% so far this year.
The company, owned by India's Tata Motors, began talks with Chery months ago, but had been awaiting approval. A joint statement released by the Chinese and British companies said: "We are delighted to have reached this milestone, achieved thanks to the understanding and foresight of the Chinese authorities and we want to thank them for recognising the potential of our joint venture in the fast-growing Chinese market. "Together, we will now begin working in close collaboration on our partnership plans to harness the capabilities of our respective companies, to produce relevant, advanced models for Chinese consumers."
JLR has not said officially which model would be built at the factory, although the company has said in the past that is likely to be either the Land Rover Freelander or Evoque. A research and development facility and engine production plant will also built as part of the venture, with the main manufacturing plant expected to be completed during 2014, with production starting the following year. With China now a crucial market for JLR, building vehicles in the country means it can avoid import duties. However, JLR says that being in China will enable it to build vehicles designed specifically for the Chinese market.

`Benefits of using joint ventures as a way of promoting growth and development	Evaluation: Disadvantages, limitations, success depends on…

ii. Buffer stock schemes

This links to primary product dependency as a factor influencing growth and development (See course companion 2 and theme 1 work on commodity markets)

Why do prices tend to fluctuate in commodity markets, e.g. coffee or barley?

Analyse how price fluctuations could limit growth and development

Solutions to price fluctuations include minimum price schemes and buffer stocks:

Buffer stock scheme: a scheme whereby an organisation buys and sells in the open market so as to maintain minimum and maximum prices in the market for a product.

The aim is to **stabilise** the price of the commodity.

Note: The organisation could be:
National government stabilising prices within their country (requires trade restrictions with the rest of the world) e.g. Thailand buffer stock for rice
International organisation where all main producers of commodity try to stabilise world price, e.g. International Tin Council.

Buffer stock diagram:

'Good harvest'

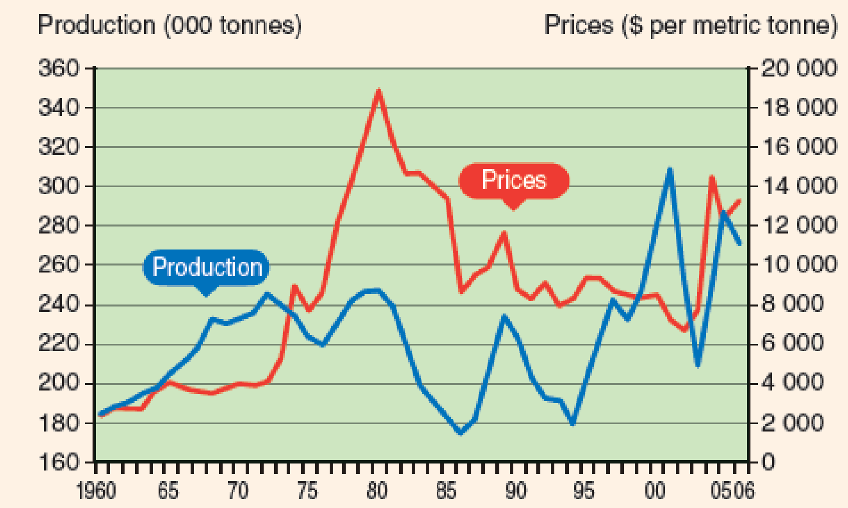
- A 'good harvest' shifts the supply curve shifts to the right to **S2,** causing the market price to fall.
- As the price falls to P2, the organisation steps into the market and __________ **XY** for the buffer stock, stabilising the price at P2.

'Bad harvest'

- A ‘bad harvest’ shifts the supply curve to the left to **S3,** causing the market price to rise.
- As the price reaches P3, the organisation steps into the market, ________ **AB** from the buffer stock, stabilising the price at P3.

Historical example: International Tin Council

Figure 7 Prices and world production of tin



Source: adapted from *Historical Statistics for Mineral Commodities in the United States, Metal prices in the United States through 1998*, United States Geological Survey

The world tin industry has commodity agreements going back to 1921. The International Tin Council (ITC) came into being in 1956. It was able to support the price of tin during periods of low prices by buying tin for its buffer stockpile and selling tin when prices were high. During the 1970s, its stockpile of tin was not sufficiently large to prevent serious price rises in the commodity. However, the world recession of 1981-2 hit world tin consumption. The ITC was able to avoid sharp declines in tin prices by buying in the open market. However, it was only able to afford the cost of increasing its stockpile by extensive borrowing from banks and metal trading firms. In late 1985, it reached its credit limits and its supporters, such as the UK, refused to extend further credit. The International Tin Council was disbanded and its stocks sold off over a four-year period. Prices did not recover their early 1980 levels until 2004 when sharp increases in demand from booming countries of East Asia, particularly China, fuelled a commodity price boom.

Thailand’s misguided rice policy

North Eastern Thailand produces high quality jasmine rice, but low farm incomes and fluctuating rice prices have resulted in a lack of investment in irrigation. This increases risks for farmers: one year there is no rain, the next year floods, so that crops fail and farmers get into debt. In contrast, in the central plains region, farmers benefit from irrigation and grow up to three crops a year of high yield (but lower quality) varieties, much of which has been exported.

In 2001 the government set up a buffer stock scheme, to stabilise rice prices by allowing farmers to sell their rice to the government for a guaranteed price. But it is argued the scheme has become riddled with corruption and mainly benefits the rich farmers with irrigation. The poor farmers from the North East do not have much surplus to sell.

Those with rice would only sell it to the government. Rice traders, like Asia Golden Rice, one of Thailand’s most successful, found it difficult to buy supplies at competitive prices for their overseas customers. They fear losing export markets to competitors.

The scheme is also very expensive for the government, especially now, because last year, when rice prices were unusually volatile, a weak government set the guaranteed price too high. It is estimated to have cost 11 billion baht ($325 m) just to process and store crops bought under the buffer stock scheme. Also because rice prices have fallen this year, when the government sells the stocks it is estimated to lose another 20 billion baht ($590m).

Attempts by a government minister to close down the buffer stock, and replace it by a simpler subsidy, have been blocked by coalition partners in the government. There are suspicions that a lot of politicians are making money out of the scheme, perhaps from warehouse-keepers storing the rice, or traders trying to buy at bargain prices.
Source: BBC News 14/7/2009

What are the advantages and disadvantages of a buffer stock scheme?

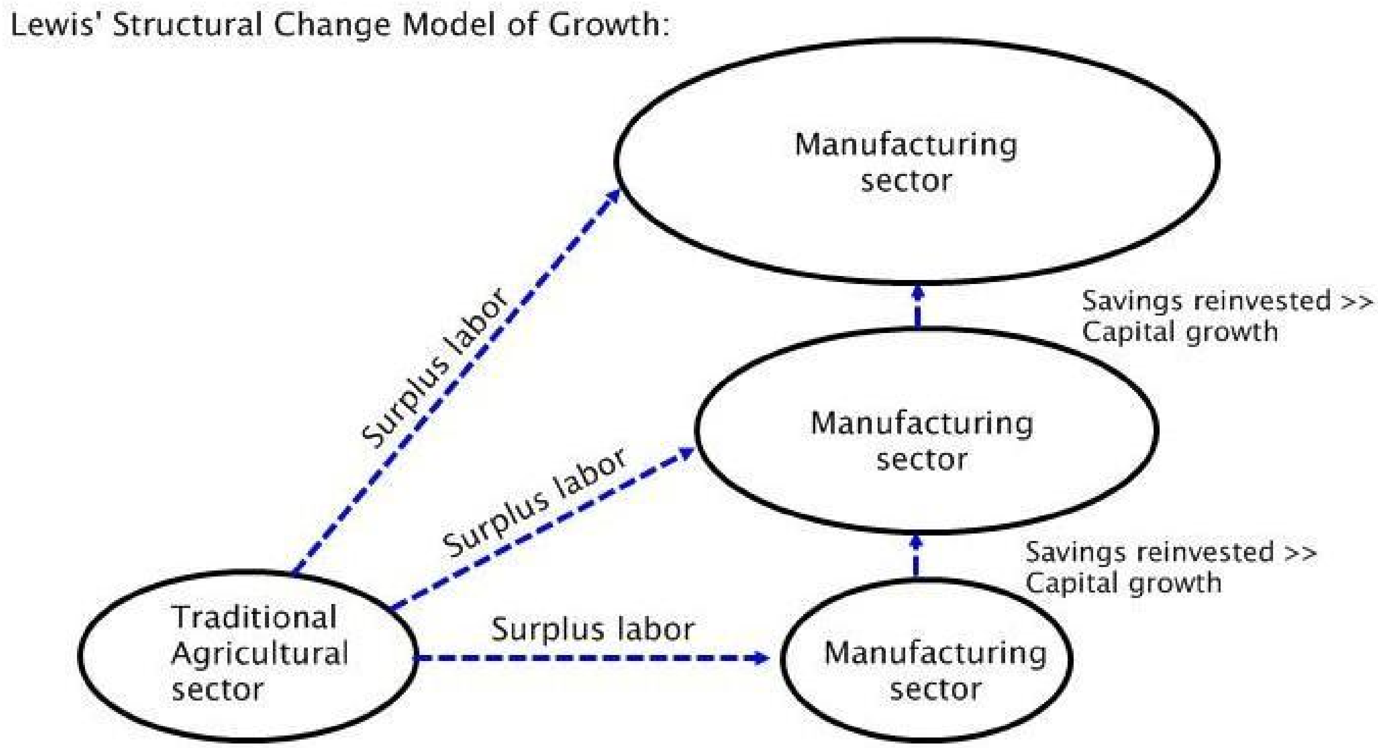
Advantages of buffer stock schemes as a way of promoting growth and development	Evaluation: Disadvantages, limitations, success depends on … (depends on type of commodity?)

Other strategies influencing growth and development

i. Industrialisation: Lewis 2-Sector model (Structural change model) (1954)

Lewis model of structural change: a model in which the economy is split into a **rural agricultural sector** and an **urban industrial sector**. Development is promoted by **the transfer of surplus labour** away from the agricultural sector, attracted by the higher wages available in manufacturing industry.

Dualism: a sharp division between sectors of an economy (for example, agricultural and industrial sectors) or between the living standards of different groups of people (both within countries and on an international level).



- Lewis argued growth could be sustained by the gradual transfer of workers from **low productivity agriculture** (the traditional sector), **to higher productivity urban secondary and tertiary industries** (the modern sector). This would occur through **higher wage incentives.**
- He argued workers were unemployed/underemployed in agriculture: Low labour productivity caused by **Law of Diminishing Returns**, as each additional worker added to fixed (perhaps poor quality) land & capital, marginal product of labour declined, perhaps to zero.
- Higher productivity of workers in modern sector allowed employers to offer higher wages, while still retaining profit for expansion.
- Rate of this transfer depended on rate of capital accumulation in the modern sector of the economy: greater investment leads to faster transfer.
- Process of modern sector growth continues until all available rural sector labour has been transferred.

Policy implications
- Interventionist economists suggest that government should promote industrialisation in order to promote economic development.

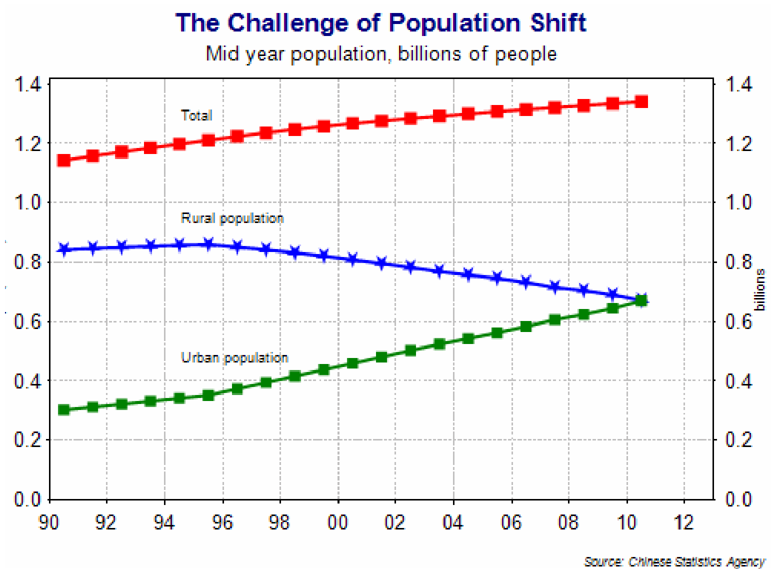
- **Evaluation of the model:**
- Population in urban slums often unemployed, and would be more productive in the rural sector.
- Lack of urban housing, slums without access to clean water & sanitation.
- The theory assumes secondary sector production would be labour-intensive, whereas it is often capital-intensive.
- Evidence: migration from rural to urban areas has been similar across all regions of the developing world, but regions have very differing growth rates of GNP per capita
- E F Schumacher (Economist) argued small scale, rural investment better.

Country example: Structural change in China
Watch short video clip: China's population shift to the city:
http://www.bbc.co.uk/news/business-16605858

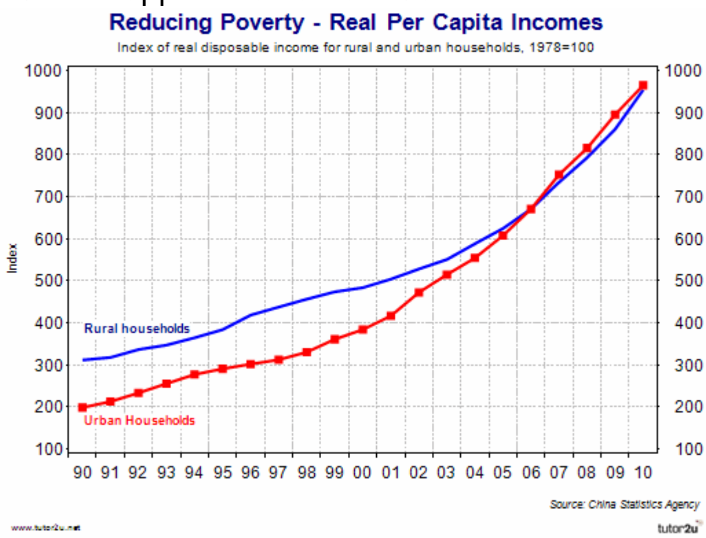
1. Why have people moved to the cities?

2. What proportion of Chinas population are expected to live in the cities by 2030?

What happened in the UK in 1851, the United States in 1920 and in the World in 2008? These three years mark the estimated year when the size of a given urban population overtook the size of the rural population. And now China has reached this significant landmark. The Chinese Bureau for National Statistics reported recently that in 2011, the proportion of urban population reached 51.27 percent (1.3% higher than in 2010) with the urban population standing at 690.79 million persons, an increase of 21 million persons in a year. China's rural population stood at 656.56 million persons and for the first time her urban population was 34.23 million persons more than the rural population.



Source: Tutor2uSource:
http://www.tutor2u.net/blog/index.php/economics/comments/unit-2-macro-population-shift-in-china#extended
Class work: To what extent does the data from China support the Lewis 2-Sector Model?



Country example: India

http://www.tutor2u.net/blog/index.php/economics/comments/unit-4-macro-has-india-missed-the-manufacturing-boat
Watch the video clip and note problems with developing manufacturing industry in India as a way of promoting growth/development.

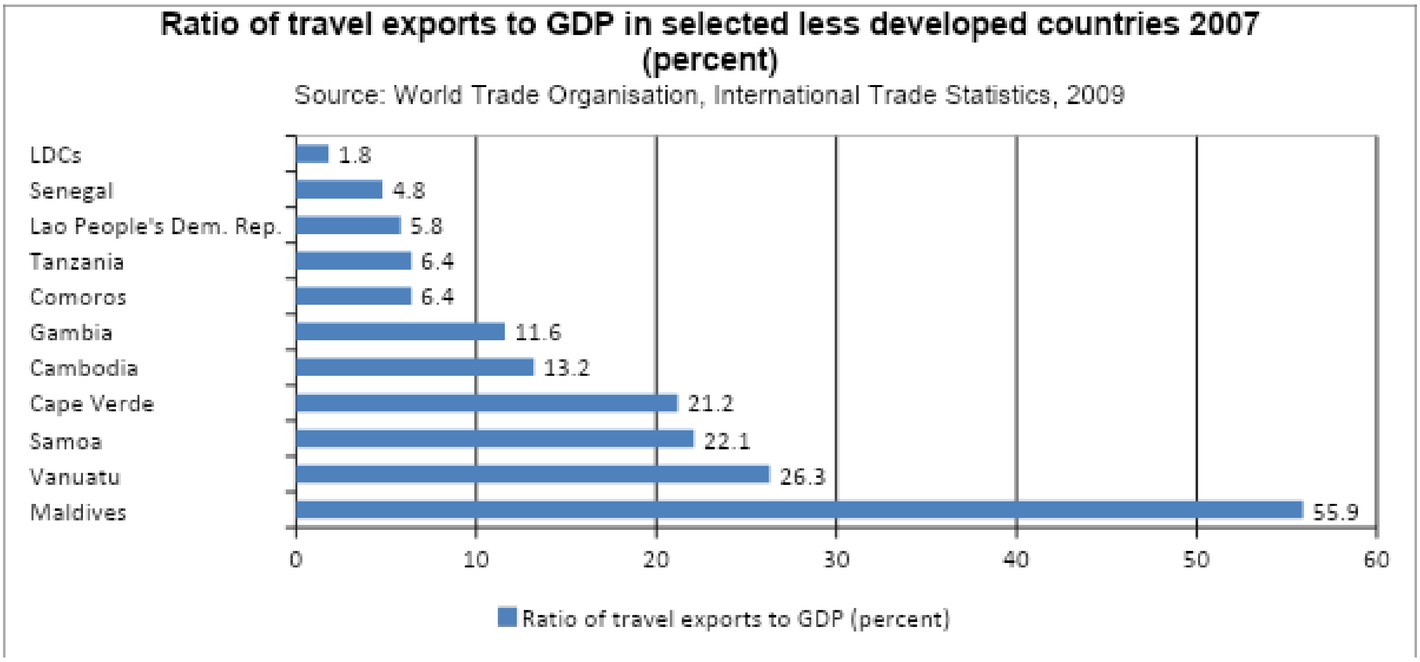
Using the information above, and everything we have learnt throughout the course so far, evaluate industrialisation as a strategy for growth and development:

Benefits of industrialisation in promoting growth and development	Evaluation: Disadvantages, limitations, success depends on….
More employment with higher skills – higher wages.	Multiplier effects means even greater growth in the economy will occur – level is 1.6 in developing countries for investment projects. Danger of moving to deindustrialisation in the long run – danger of structural unemployment. CCEV – New tertiary sector would still be created.
Increase in exports – export led growth	Depends on exchange rates – now exposed to fluctuations in this and the trends of the global market.
Leads to external economies of scale and specialisation, and avoids any diminishing returns in the agricultural sector through the Lewis 2 stage model.	Expensive and very long scale. Diminishing returns will set in sooner or later to the manufacturing sector.
Building up a good infrastructure in the long run.	Hi tech manfufacturing means not as many jobs created. Higher levels of unemployment in urban areas. Negative externalities – production and consumption. Other countries may be left to deal with this (India v Maldives).
Move away from primary product dependency.	Spreads risk.

ii. Development of tourism

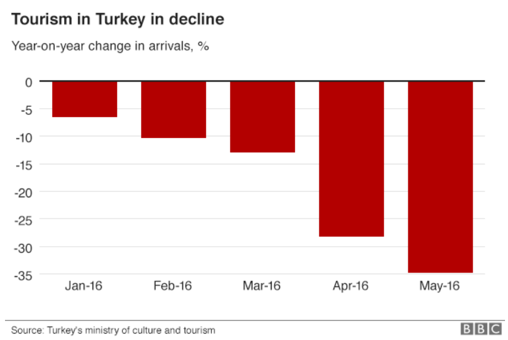
Development of tourism

- Growth of tourism high since 1970s as high YED.
- Travel receipts account for over a third of all service exports for LDCs, a higher proportion than developed countries.
- For the top 20 countries, which specialise in tourism, the industry accounts for between 60% and 90% of total service exports.



Tourism in Africa
http://www.tutor2u.net/blog/index.php/economics/comments/unit-4-macro-tourism-and-economic-development
Watch the video clip and note benefits of tourism & what success depends on.

Country example: Turkey
http://www.bbc.co.uk/news/world-36559245
Take notes on problems experienced by the tourist industry in Turkey in 2016



Country examples: Senegal and Egypt

Over the past 30 years, Senegal has established itself as a leader in West African tourism. For Senegal, tourism is its largest foreign exchange earner, twice as important as fishing, the next largest. Around 700 000 visitors a year came to the country in 2003, which the government wants to raise to 1.5 million by 2010.

However, the industry has its problems. Half of its visitors come from France, a legacy of its colonial past. British, German and Scandinavian tourists tend to go to the neighbouring country of Gambia, depriving Senegal of much needed revenues. The hotel infrastructure in Senegal is satisfactory but average occupancy rates of 37 per cent or less mean that returns are slim to justify further investment. One of the two main beach resorts, Cap Skirring in the Casamance region, has suffered as a result of a long-running separatist conflict in the area. The other, Saly-Portudal, has gained a negative image in France. Dakar itself is popular with business tourists. It is a favourite venue to hold conferences and congresses and is also a venue for events such as the Dakar Rally.

Studies made for the government of the tourism industry identify weaknesses such as environmental degradation and low levels of local involvement. The market needs to be become more diversified, attracting tourists from a greater range of countries and offering a greater number of tourist attractions. Facilities such as Dakar airport, the entry point for most tourists, need upgrading. The industry also needs to become less seasonal to increase occupancy rates and profits.

Source: adapted from the *Financial Times*, 2.2.2005.

Over the past twenty years, Egypt has suffered from a series of terrorist outrages which have targeted the tourist industry. Each has led to a sudden and immediate drop in the number of tourists visiting the country. However, the 'bounce back' period has become shorter and shorter as tourists recognise they could become victims anywhere in the world. In 2004, three bombs targeting tourists and Egyptian workers in the tourist industry in Sharm el-Sheikh killed 88 people and injured a further 150. Despite this, 8 million tourists came to Egypt in 2004 and the numbers are still growing.

The potential for tourism is enormous. Egypt has cultural heritage which attracts one type of tourist. It also has a year round attractive climate on the Red Sea which attracts beach lovers. However, Egypt's infrastructure is a constraint on expansion. Some areas with historical sites such as Luxor and Aswan have become 'overdosed'. Yet there are many more sites with potential which are inaccessible to large numbers of tourists because of lack of roads and internal air flights. In the coastal resorts, investment capital is needed for expansion. One new source of revenues is a growing British investment in villas. Rather than buying a second home in Spain, some British people are buying in Egypt. This creates both jobs in construction and also a variety of jobs in service industries afterwards.

However, the threat of terrorism remains significant for Egypt. For Egyptians involved in the tourist trade, not only do they face attacks, but also they can see their coming year's income wiped out in a split second.

Source: adapted from the *Financial Times*, 7.12.2005.

Development of tourism as a way of promoting growth and development: Read the text above for country examples

Analysis: Advantages of developing tourism as a way of promoting growth and development	Evaluation: Disadvantages, limitations, what does success depend on
Creation of jobs, e.g. jobs in construction, hotel staff. Tourism is labour intensive. Job creation for local suppliers	Jobs in construction are temporary. Hotel staff paid low wages by international hotel chains? International hotel chain bring in foreign workers? Seasonal unemployment.
Boosts AD with regional multiplier effects	Poorer areas, higher MPC so higher multiplier. Inflationary/overheating depending on the state of the economy. Eg: Turkey.
Income elastic – as global incomes rise, there will be an increase in demand for tourism	Covid means sudden drop to no Tourism. Samoa. Restrictions on vaccines may make it more difficult for tourists to travel. Time scale – long time to increase/development.
I Increased tax revenues for the government	Foreign owned hotels - profits moved abroad.
May lead to improvements in infrastructure (e.g. international hotel provides new roads as part of its contract to build hotels)	Over development means lack of allocative efficiency/correct infrastructure. The difference between tourist heavy areas and outside of these areas. Building infrastructure difficult in tourist areas – congestion putting off the Tourists.

iii. Development of primary industries

Some countries have managed to develop on the basis of primary industries, in which they have a comparative advantage specialising in:

- Hard commodities e.g. oil, copper
- Soft commodities e.g. cocoa, sugar

Primary product dependency creates many problems as discussed in course companion 2. Here we shall discuss further the particular merits of developing the agricultural sector.

Country example: Kenya
https://www.youtube.com/watch?v=oDlqA9PUMTs
Watch the video clip 'Kenya's hi-tech dairy solution' and take notes on the benefits of innovation in Kenya's diary industry:

Based on the above article, the video clips and everything you have learnt on the course so far, complete the table below:

Benefits of developing agriculture as a way of promoting growth and development	Evaluation: disadvantages, limitations, success depends on…
1) Affordable – labour intensive and low skilled – less risk of labour being replaced by capital, reduce inequality, prevent structural unemployment. 2) Domestically produced food = self sustainability. 3) More jobs created in rural areas. 4) Diversifies the economy? 5) Food has a high inelasticity – stable market	- Lewis model suggests movement away from low productivity agricultural sector to higher productivity manufacturing / service industries is desirable for growth. Less exposure to export markets and exchange rates. Offsets the problems of the Lewis 2-sector model. Negative externalities of production – cows – methane – major cause of climate change, insecticides, pesticides. Does it increase primary product dependency? Set up a secure income stream with certainty which investors like. CEV – how secure?

iv. Fairtrade schemes

The aim of fair trade schemes is 'to address the injustice of low prices' by guaranteeing that producers receive a fair price.

- Producers paid an above-market price for their produce
- Fair trade also linked to community development, fair working practices and the environment: e.g. no child labour, production must be sustainable, no environmental degradation.
- 2013 fair trade sales £4.4 billion worldwide, a very small percentage of total world trade.
- 2013: 1.5 million farmers and workers were in fair trade certified producer organisations, only a fraction of the developing world's working population.
- Fair Trade is particularly significant in a few product categories, such as coffee and tea.

Ted talk on fair trade https://www.youtube.com/watch?v=a7X5eEimFD8

Why was Fair Trade good for coffee farmers in Nicaragua?

How did it help promote development?

Other issues discussed

vi. Aid

Aid: Voluntary transfer of resources from one country to another or loans given on concessionary terms (i.e. at less than the market rate of interest)

Types of foreign aid:
Grants: sums of money that do not need to be repaid, e.g. give money to LDC for development project, offer free technical expertise or offer free university education for foreign students in donor country. Humanitarian aid for natural disasters e.g. earth quake, famine.

Soft loan: a loan, which carries lower rate of interest than the commercial rate of interest.

Tied aid: aid with conditions attached, e.g. only if used to purchase goods/services from donor country.

Bilateral aid: given directly from one country to another (often tied).

Multilateral aid: Aid given by more than one country and channelled through international bodies e.g. World Bank

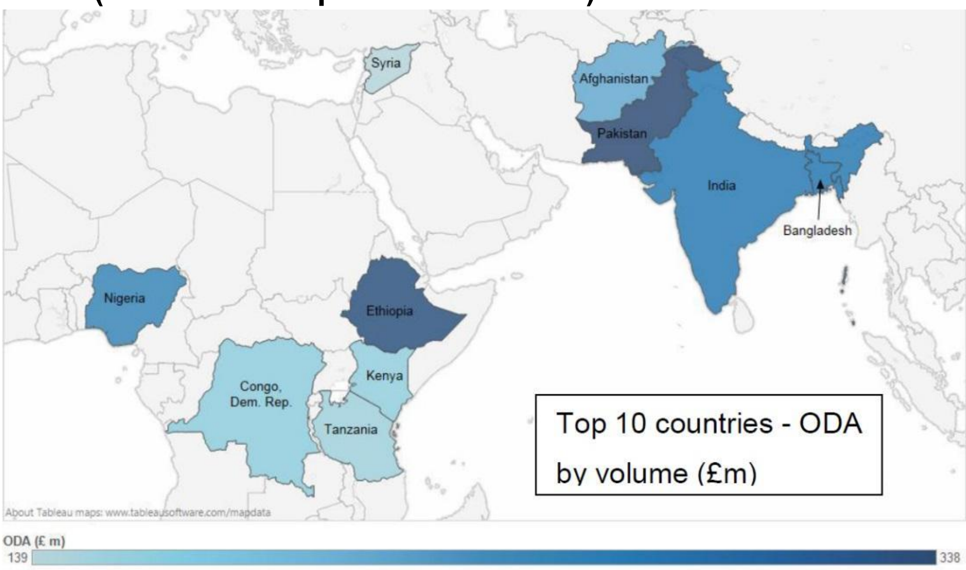
Official development assistance (ODA): aid provided by governments

Technical assistance: Funding of expertise of various types.

Humanitarian aid: emergency disaster relief, food aid, refugee relief and disaster preparedness.

UN goal for amount of aid offered by developed countries (agreed 1970) is 0.7% of GDP.

UK aid (official development assistance) *various sources*



The top three recipients of UK Net Bilateral ODA in 2013 were Pakistan (£338m)**, Ethiopia** (£329m), and **Bangladesh** (£272m).

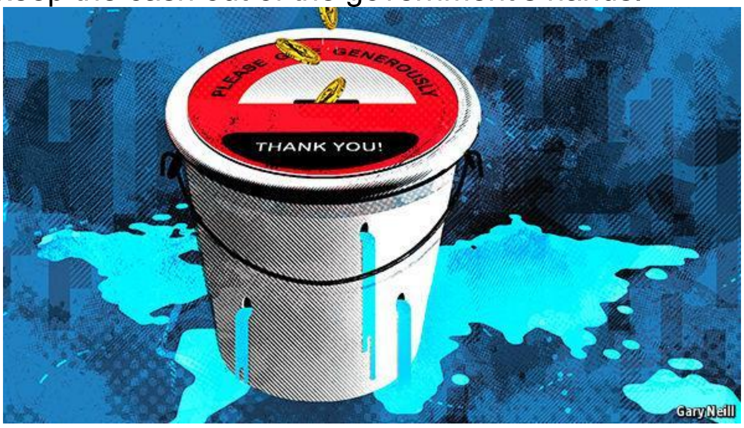
Africa region received the largest amount of UK Net Bilateral ODA, £2,509 million in 2013, an increase of 15.4 per cent on 2012

In the last couple of years nearly 40 per cent of the budget has gone to multilateral organisations, such as the United Nations, while the remaining 60 per cent has gone to developing countries, known as bilateral aid. The most recent full report on the UK's international development statistics, which is for 2013, shows that Pakistan, Ethiopia and Bangladesh received the most bilateral aid from the UK. The sector that benefited most from UK bilateral aid was health.

Examples of current aid priorities and projects

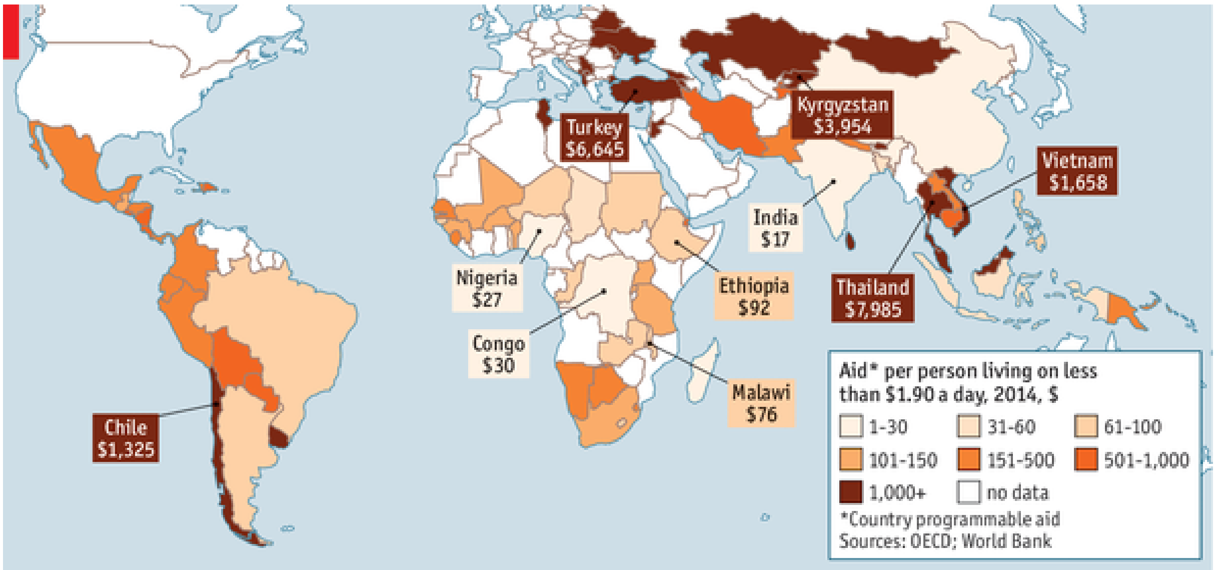
The Department for International Development's priorities for 2015 included helping nine million children into primary school, immunising more than 55 million children against preventable diseases, saving the lives of at least 250,000 new-born babies and encouraging global action on climate change. One recent example of spending was a grant of £724,500 to Medical Aid for Palestinians to deliver trauma support and plastic reconstructive surgery for many of those injured in the recent Gaza conflict. Another example was the £230m +, to help control the spread of Ebola.

Aid is best spent in poor, well-governed countries. That isn't where it goes
Jun 11th 2016 | The Economist
NOT long ago Malawi was a donor darling. Being dirt poor and ravaged by AIDS, it was needy; with just 17m inhabitants, a dollop of aid might visibly improve it. Better still, it was more-or-less democratic and its leader, Joyce Banda, was welcome at Westminster and the White House. In 2012 Western countries showered $1.17 billion on it, and foreign aid accounted for 28% of gross national income.
The following year corrupt officials, businessmen and politicians pinched at least $30m from the Malawian treasury. A bureaucrat investigating the thefts was shot three times (he survived, somehow). Germany said it would help pay for an investigation; later, burglars raided the home of a German official and stole documents relating to the scandal. Malawi is no longer a donor darling. It now resembles a clingy lover, which would be dumped were it not so needy. It still gets a lot of foreign aid ($930m in 2014), but donors try to keep the cash out of the government's hands.



Foreign aid can work wonders. It set South Korea and Taiwan on the path to riches, helped extinguish smallpox in the 1970s and has almost eliminated polio. Unfortunately, as Malawi shows, it is liable to be snaffled by crooks. Aid can also burden weak bureaucracies, distort markets, prop up dictators and help prolong civil wars. Taxpayers in rich countries dislike their cash being spent on Mercedes-Benzes. So donors strive to send the right sort of aid to the places where it will do the most good. How are they doing?
A decade ago governments rich and poor set out to define good aid. They declared that aid should be for improving the lot of poor people—and not, implicitly, for propping up friendly dictators or winning business for exporters. It should be coordinated; otherwise, says William Easterly of New York University, "the poor health minister is dealing with dozens of different donors and dozens of different forms to fill out." It should be transparent. Where possible, it should flow through governments.
Official development aid, which includes grants, loans, technical advice and debt forgiveness, is worth about $130 billion a year. More than two-fifths flows through multilateral outfits such as the World Bank, the UN and the Global Fund. Last year 9% was spent on refugees in donor countries, reflecting the surge of migrants to Europe.

India contains some 275m people living on less than $1.90 a day. It got $4.8 billion in “country programmable aid” (the most routine kind) in 2014, which is $17 per poor person. Vietnam also got $4.8 billion; but, because it is much smaller and rather better off, that works out to $1,658 per poor person (see map). By this measure South-East Asia and South America fare especially well.



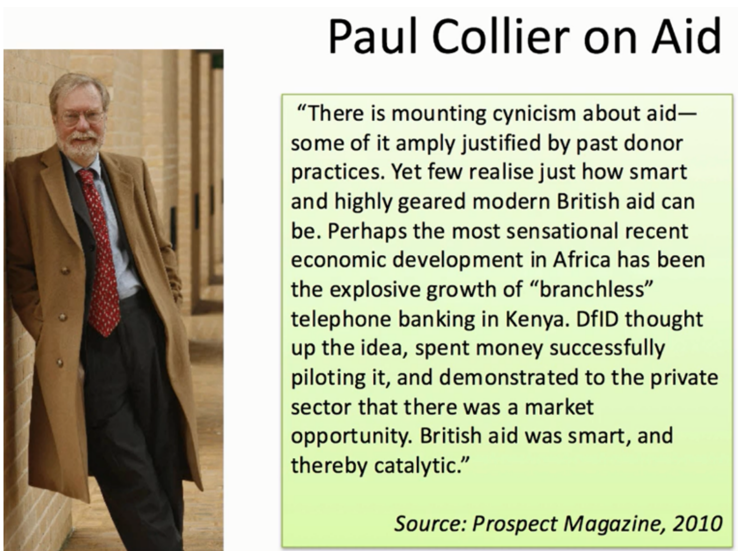
Economist.com

Aid is used more-or-less explicitly as a tool of foreign policy—and increasingly so, says Owen Barder of the Centre for Global Development, a think-tank. Today’s enemy is not communism but radical Islam. Afghanistan, Egypt, Jordan, Syria and Turkey each got more net aid than Bangladesh in 2014, although none contains nearly as many poor people. This week the EU promised more aid to African and Middle Eastern countries that clamp down on migrants.

The surge of aid into strategically important states is often huge. Net foreign aid to Turkey, an increasingly autocratic country that is not poor, rose more than tenfold between 2004 and 2014, to $3.4 billion. Once countries have joined the democratic club, aid drops. American aid to Peru followed that pattern. “You get penalised for achieving too high a level of democratic governance,” says Brad Parks of AidData, another think-tank.

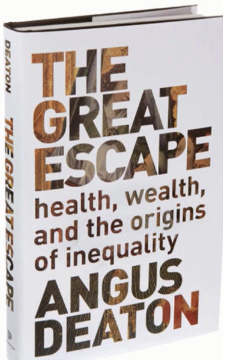
Aid has become less important to many poor countries than foreign investment or remittances. And donors have become far more diverse. China distributed roughly $3.4 billion last year, according to the OECD. Last month it promised Malawi more food aid and 100 police cars. For corrupt dictators, Chinese aid is even better than the Western kind. China tends not to fuss over democracy, and it seldom objects to loans being spent on pointless grand projects: after all, it builds a lot of those at home. The money is easier to snaffle. One study found that Chinese aid is highly likely to flow to the districts where African leaders were born.

Different views on aid



Angus Deaton on Aid

- When the conditions for development are present, aid is not required. When they do not exist, aid is not useful and probably damaging
- Foreign aid is antidemocratic because it frees local leaders from having to obtain the consent of the governed



Read the information above and complete the table below:

Advantages: analyse how aid promotes growth & development	Evaluation: disadvantage, limitations, what does success depend on?
● Harrod Domar & Rostow models: foreign aid desirable to fill savings gap.	● Dependency theories: soft loans (even at low interest rates) make country dependent on Western Developed country.

vii. Debt Relief

https://www.tutor2u.net/economics/reference/external-debt-relief

Using the data and videos in the above link complete the table below:

Advantages: analyse how debt relief promotes growth & development	Evaluation: disadvantage, limitations, what does success depend on?

What's best for developing countries: aid or remittances?

A remittance is a transfer of money by a migrant worker to an individual in his or her home country e.g. teacher working in UK sends money home to mother in Ghana

In the current economic climate of austerity and government cut backs there has been some debate as to whether the aid budget to help developing countries will be a victim. However, is aid the best policy to assist those countries? Some have suggested that remittances from immigrants living abroad are a more effective tool for assisting those countries that are of developing status.

Remittances

To give an indication of the scale of remittances, the World Bank has estimated that in 2010 the volume of remittances was three times that of official aid – $375bn as opposed to $125bn. This figure might even be higher as it is a lot harder to track transactions from smaller money shops. Below are some examples of the importance of remittances in some developing countries:

- **Sri Lanka** – remittances > tea exports receipts
- **Nepal** – remittances > tourism receipts
- **Morocco** - remittances > tourism receipts
- **Egypt** – remittances > revenue from the Suez Canal

Although the financial contribution of remittances is extremely prevalent is it actually a viable option for developing countries instead of foreign aid?

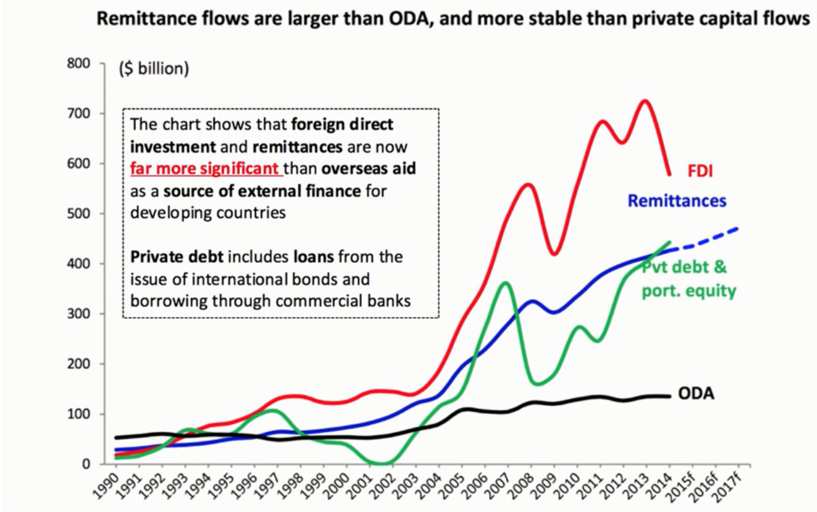
Advantages of Remittances

- money goes directly to the people it is intend for which means is less opportunity for waste or corruption
- money can be spent by the individual on areas like education and healthcare which may not be possible with official aid
- the consumer has considerably more sovereignty
- the sender is confident that the money will be used effectively which might not be the case with official aid.

Limitations of Remittances

- the development of infrastructure projects need sizeable funds which individual remittances cannot provide. For instance schools, hospitals, roads, bridges etc. need concentrated funds.
- they tend not to target those who are desperately in need – both countries and individuals.

Financial Flows to Developing Economies



Developing Countries Most Dependent on Remittances

Country	Net official development assistance received (2012)	Remittances, inflows (2012)
	(% of GNI)	(% of GDP)
Tajikistan	5.5	46.9
Kyrgyzstan	9.2	27.6
Lesotho	9.0	25.7
Liberia	53.6	23.3
Moldova	6.0	22.8
Nepal	4.7	22.2
Samoa	16.6	21.9
Haiti	23.2	21.1
Lebanon	1.1	18.3
Jamaica	0.4	14.6
Guyana	6.2	14.5
Jordan	3.3	12.0
Bangladesh	0.9	10.8
Philippines	-0.1	10.5

What is best for developing countries – aid or remittances?

Read the information above to complete the table below:

Advantages of remittances as a way of promoting growth & development:	Evaluation: Disadvantages, limitations, depends on…

Further research: African aid: Helpful or hazardous? (first 24 mins) (April 2012) http://www.tutor2u.net/blog/index.php/economics/comments/unit-4-macro-african-aid-helpful-or-harmful#extended

Awareness of the role of international institutions and non-government organisations (NGOs)

The World Bank

The World Bank: was founded after the Second World War to **promote economic development**. It provides low-interest **loans**, interest-free credit and **grants** to developing countries for **education, health, infrastructure**, communications and other developmental purposes.

The main functions of the World Bank include:

- Granting reconstruction loans to war devastated countries
- Granting developmental loans to underdeveloped countries
- Providing loans to governments for agriculture, irrigation, power, transport, water supply, education, health, etc.
- Encouraging industrial development of underdeveloped countries by promoting economic reforms.

History

At the Bretton Woods conference after World War 2, three institutions were set up:

- The IMF – to help countries with balance of payments difficulties
- The World Bank – to provide assistance on long term development issues
- WTO (formerly GATT) – to aim to reduce trade barriers

The World Bank

The World Bank was set up to promote economic development and originally gave long term loans for reconstruction and development to nations after world war two. It is made up of the International bank for reconstruction and development (IBRD) which focuses on middle income and creditworthy poor countries and the International Development Association (IDA) which focuses on the poorest countries. In the 1970s, the role of the World Bank changed to giving loans and providing expertise in setting up agricultural reforms in developing countries. In the early

1980's, Mexico defaulted on its loans and since then the World Bank imposes **structural adjustment programmes** (SAPs) which set conditions for the loans to ensure that the debtor pays it back. The SAPS were based on **free market reforms**, e.g. trade liberalisation, removing state subsidies on food, privatisation and reducing public expenditure to reduce budget deficits. However, these free market reforms were criticised because they did little to help the world's poor, failed to promote development, increased inequality and caused environmental damage. As a result, the World Bank changed its focus to **poverty reduction strategies** with aid directed to countries following sound macroeconomic policies; healthcare and broadening education, focussing on local communities rather than central governments. The World Bank is based in Washington DC and the current president of the World Bank is Jim Yong Kim. (The head of the World Bank is often American). It obtains it funds from various sources: Developed countries have agreed to deposit money with the bank, it also borrows on international money markets and can make new loans with money coming in from repayments of existing loans.
http://www.worldbank.org/

1. What do 'SAPs' stand for?

2. Explain two of the free market reforms mentioned above

3. Why have SAPs been criticised

Based on the information above and your own economic knowledge, complete the table below:

Advantages of The World Bank in promoting growth & development	Evaluation: Disadvantages, weaknesses, limitations, success depends on…

International Monetary Fund (IMF)

International Monetary Fund (IMF): The IMF was set up after world war two to promote world development and stability. Its specific purpose is to '**promote international monetary co-operation**, exchange rate stability and **orderly exchange rate arrangements**; to **foster economic growth** and high levels of employment; and to provide **temporary financial assistance** to countries to help **ease balance of payments adjustment'**. (IMF).

The main functions of the International Monetary Fund (IMF) include:

- to ensure the **stability of the international monetary system** – the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other;
- to maintain stability and prevent crises in the international monetary system by **reviewing country policies** and national, regional and global economic and financial developments through a formal system known as surveillance**;**
- to provide member countries with **finance** to correct balance of payments problems

Key IMF activities
The IMF supports its membership by providing

- **policy advice** to governments and central banks based on analysis of economic trends and cross-country experiences;
- **research, statistics, forecasts**, and analysis based on tracking of global, regional, and individual economies and markets;
- **loans** to help countries **overcome economic difficulties;**

- **concessional loans** to help **fight poverty** in developing countries; and
- **technical assistance and training** to help countries improve the management of their economies

Temporary financial assistance to finance deficit on current account

- IMF provides loans in short term so country can continue importing goods
- But IMF insists on changes to macroeconomic policies (stabilisation programmes) to resolve the underlying issues and enable the loan to be repaid.
- The reform programme is usually painful and often unpopular i.e. involves less imports & more exports, reducing domestic consumption.

Source: http://www.imf.org/external/about/whatwedo.htm

The IMF is based in Washington DC, the current CEO is Christine Lagarde. (Typically, the head of the IMF is European)

Watch the video clip and take notes on how the IMF handled the Global Financial Crisis (2008):
http://www.imf.org/external/about/whatwedo.htm

International Monetary Fund: Includes country examples Iceland, Greece

The International Monetary Fund

What is its real purpose?

The role of the International Monetary Fund has been widely misunderstood. In this article, Nigel Watson sets out to dispel some of the myths that have arisen

The International Monetary Fund (IMF) was set up in 1948 alongside the World Bank as part of the Bretton Woods agreement. Most A-level economics students have a good understanding of what the World Bank does. Its role is to make loans to governments in the developing world, which are used to finance investment in infrastructure projects. Unfortunately, knowledge of the IMF is less accurate. This is largely due to myths about the IMF that have been propagated by the mainstream media. Many of these myths have found their way into A-level economics.

The textbook account

According to many textbooks, the IMF has two main roles:

- to make emergency loans to countries that are struggling to obtain the foreign currency needed to finance their current account deficits
- to stabilise a country's exchange rate

Financing a current account deficit

Countries run current account deficits on the balance of payments when their import expenditure exceeds their export income. These countries are net importers. By choosing to consume more than they produce, countries that run current account deficits have chosen to live beyond their collective means.

The foreign currency needed to run a current account deficit is obtained by running a financial (capital) account surplus. Net currency inflows on the financial account can be created by selling off income-generating assets to foreign buyers. In polite circles this is usually described as 'attracting inward foreign direct investment'. For the majority of the last 30 years, the UK has financed its current account deficit by selling off companies such as Jaguar Land Rover and Cadbury, and even football clubs like Manchester United, Chelsea and Liverpool.

The second way of obtaining the foreign currency needed to be a net importer is to borrow from abroad. During the last boom UK banks such as Northern Rock borrowed loanable funds from countries that ran current account surpluses. British banks then lent the money that they had borrowed to UK households and firms so that they could purchase goods and services, many of which were imported.

Taking on external debt and selling assets to finance consumption will boost a country's standard of living in the short run. However, this type of economic growth is rarely sustainable in the long run. As a country's debts rise, lenders start to question the creditworthiness of the country that habitually borrows to live beyond its collective means. In addition, assets can only be sold off once. So this source of finance will eventually dry up too.

According to the textbook account, countries that cannot raise the foreign currency needed to pay for their current account deficit can borrow from the IMF. The foreign currency obtained from the IMF can then be used to pay for essential imports.

The average A-level economics textbook does not explain how governments distribute IMF loans to enable households to perpetuate their consumption of imports. In a mixed economy the majority of a country's imports are bought by households and firms rather than by the government. Therefore, if a government really wanted to use an IMF loan to finance a current account deficit, it would have to find a way of distributing the IMF loan to households and firms. The extra liquidity made possible by an IMF loan would enable banks to extend new lines of credit to households and firms. This credit could be used to buy additional imports.

Stabilising the exchange rate

At the time of the Bretton Woods agreement most countries ran fixed exchange rates. The consensus then was that fixed exchange rates offered greater certainty than floating exchange rates. The increase in confidence created would encourage more firms to export, leading to a bigger global economy. If a country's currency peg came under downward pressure, a government could accept a foreign currency loan from the IMF. The US dollars borrowed could then be sold in the FOREX market and the proceeds used to buy domestic currency.

The theory was that the increase in demand for domestic currency created indirectly by the IMF loan would prevent the currency depreciation that would have otherwise occurred. In effect, this entails maintaining the exchange rate by taking up the excess supply of currency. In other words, the authorities were reducing money supply, and thus restoring equilibrium in the exchange market by dampening domestic aggregate demand.

The change to floating exchange rates

The world has since changed. Today most countries run floating, not fixed exchange rates. Does this mean that there is no longer a need for a country to borrow from the IMF to stabilise its currency? The answer is not quite. On occasion, in the recent past, IMF money has been used to prevent floating currencies from collapsing.

A good example occurred in 2008 when the IMF granted Iceland a $2.1bn loan to stabilise the krona. Prior to the loan the Icelandic currency dropped by over 70%. The cause of the currency collapse was capital flight out of Iceland — unsurprising given that at the time Iceland was suffering from a severe financial crisis. Within a week in late 2008 the Icelandic stock market lost more than 80% of its value. In addition, three of Iceland's biggest banks failed.

Figure 1 shows how capital flight out of Iceland caused the supply of krona on FOREX markets to increase from S_1 to S_2, which led to the krona depreciating from ER_1 to ER_2. The IMF dollar-denominated loan was then used by the Icelandic central bank to buy krona. As a result, the demand for krona increased from D_1 to D_2, which pushed the exchange rate back up to ER_1.

Keynesians normally favour mild currency depreciations because they tend to improve a country's international price competitiveness by increasing import prices and decreasing export prices. However, a sudden collapse in the value of a currency will cause significant economic hardship for the population. In Iceland's case the 70% fall in the value of the krona caused import prices to rise by the same magnitude. The resulting cut in real wages caused poverty in the country to soar.

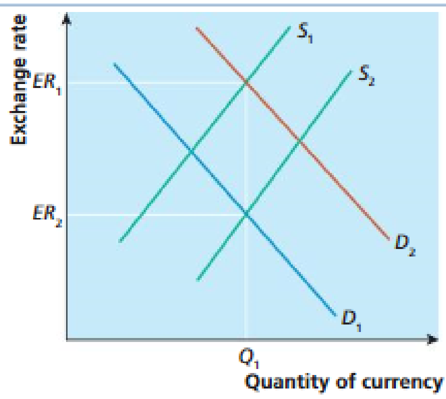


Figure 1 Capital flight from Iceland

In addition, many households in Iceland suffered from a second problem. Attracted by low Japanese interest rates, they had chosen to take out yen-denominated mortgages and car loans. When the krona crashed against the yen, their monthly mortgage repayments in krona rose by 70%. After paying the mortgage, households in this position would have virtually nothing left to pay for food and other essentials.

Therefore, it could be argued that the population of Iceland benefited from its IMF loan because without IMF intervention the

The UK has financed its current account deficit by selling off companies such as Cadbury

A SUDDEN COLLAPSE IN THE VALUE OF A CURRENCY WILL CAUSE SIGNIFICANT ECONOMIC HARDSHIP

THE IMF COULD BE SEEN AS AN INTERNATIONAL BANKER BAILOUT MACHINE

krona would have carried on falling, which would have caused an even bigger drop in living standards. However, some economists argue that the IMF was not particularly interested in saving the people of Iceland. Instead, the IMF had other reasons for granting Iceland its loan.

What the IMF really does

In practice the primary purpose of the IMF is to promote international financial stability. This is shorthand for protecting the balance sheets of financial institutions in North America and Europe that have made risky loans to public and private borrowers in other countries who might otherwise default. Borrowers default when they refuse to pay back a debt, plus any interest owed. The IMF tries to prevent defaults by granting the borrowers new loans. The money received from the IMF is then used to pay off earlier debts owed to Western banks. In essence, IMF rescue packages swap indebtedness to the IMF for indebtedness to Western banks.

IMF loans can help to promote international financial stability in two ways: by preventing sovereign defaults and by bailing out banks. These are discussed below.

Preventing sovereign defaults

Most governments borrow, because in most cases government expenditure routinely exceeds tax income. The amount that a government borrows this year to finance the shortfall in its tax income is called the fiscal deficit. The national debt is the total accumulated stock of public debt.

Governments borrow by selling bonds. A bond is a financial asset that pays a 'coupon' or a fixed rate of return to whoever has bought it. Bonds are bought by a range of financial institutions, including banks, insurance companies and pension funds, as an income-generating asset. For example, a bond with a nominal value of $5,000 offering a 5% coupon will generate an annual income of $250. This income will continue until the bond 'matures'. At maturity the bond is redeemed by the government. This means that the bondholder will receive their initial investment of $5,000 back.

A sovereign default describes a situation where a government refuses to pay its bondholders the money that is owed to them. Interest owed to bondholders is not paid. In addition, bonds that have reached maturity are not redeemed. Unsurprisingly, bonds in default become worthless overnight. This creates huge losses for the financial institutions that bought the bonds. For the financial institutions who invested heavily in these toxic bonds, the losses created by default could be high enough to sink them.

Most of the money in the Greek 'rescue package' was paid straight to French and German banks

In short, a sovereign default in one country could threaten financial stability in another. The IMF does not want this to happen, so they grant loans to governments who are in danger of defaulting. An example is the bailout of Greece in 2010 (see Box 1).

Financing bank bailouts

The IMF makes loans to governments so that they can bail out banks. These banks might need cash to survive because they are insolvent. Alternatively, an emergency cash injection could be required to overcome a liquidity problem. In this case banks might be short of cash because of a lack of confidence, which has caused capital flight. The IMF tries to prevent financial institutions from failing because a financial crisis in one country can quickly spread and infect banks in other countries. This is called contagion.

Since 2008 the IMF has made loans to Ireland, Latvia and Hungary to enable politicians in these countries to rescue private banks that had lent heavily into a property bubble that had subsequently burst. Politicians decided that these insolvent banks were too big to be allowed to fail. For example, in December 2009 the Irish government announced a €5.5 billion rescue package to save Allied Irish Bank (AIB) and Bank of Ireland.

The Icelandic currency dropped by over 70% before the IMF loan

References

For Greek government bonds held by European banks:
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On Ireland's national debt:
http://tinyurl.com/7zy8rtg
On loans to Ireland from the EU and the IMF in 2010:
http://tinyurl.com/neuje9t

Box 1 The EU and IMF bailout of Greece in May 2010

The bailout of Greece in 2010 was not designed to help Greece overcome a balance of payments problem or to stabilise its currency. In this case, there was only one reason for the IMF to lend money to Greece and that was to prevent a Greek sovereign default.

Prior to the credit crunch, highly indebted governments could borrow cheaply. Governments such as the one in Greece took advantage of low borrowing costs by using debt to finance better public services. The recession that followed the crash of 2008 dented confidence. This led to an increase in the cost of borrowing. In Greece the government debt servicing costs climbed, which created an even bigger fiscal deficit. The government was in a debt spiral, and a Greek sovereign default seemed imminent.

In May 2010 the EU and the IMF announced a €110 billion bailout loan for Greece. This was not a bailout for the people of Greece. Ordinary Greeks did not receive their share of the loan to blow recklessly on imported German BMWs. Instead, the money borrowed was used by the Greek government to pay its bondholders.

These bondholders were French and German banks. According to research carried out by the Bank for International Settlements at the end of 2010, 96% of Greek government bonds were held by European banks (see References for source). German banks alone held €22.7 billion of Greek debt.

The Greek 'rescue package' was really designed to save the German and French banking system, which would have collapsed in the event of a Greek sovereign default. Most of the money lent to Greece spent no time in Greece. Instead it was paid straight to French and German bankers.

Unfortunately, this was not the end of the Irish banking bailouts. As Ireland's recession deepened, unemployment continued to rise. This caused more houses to be repossessed at a time when house prices were still falling. This combination caused another round of losses for Ireland's banks. By the end of February 2010 the Irish government had bought €8.5 billion worth of shares in AIB, Bank of Ireland and Anglo Irish Bank. Three months later a further €4 billion of taxpayer funds was ploughed into Anglo.

The decision to transfer private banking losses to taxpayers sent Ireland's government debt through the roof. In 2008 Ireland's national debt was only 25% of the country's GDP. By 2012 this figure was above 100%. A private banking crisis became a sovereign debt crisis. To avoid default the Irish government borrowed €85 billion from the EU and the IMF in December 2010 (see References for sources for the Irish data). Some of the money borrowed was used to repay the bondholders who had financed the bailouts of 2010. The rest was kept as a reserve to provide Ireland's 'zombie banks' with the funds needed to keep them alive.

Review notes

1 The traditional view of the IMF is that it has two roles: to assist with financing a country's current account deficit and to stabilise exchange rates.
2 A current account deficit on the balance of payments arises when a country is importing more goods and services than it exports.
3 One way in which such a deficit can be financed is by selling assets, such as companies, thus balancing the current account deficit by a surplus on the financial account.
4 The deficit could also be financed by borrowing from the IMF. Such loans would also help countries operating with fixed exchange rates to maintain the value of the currency.
5 Under floating exchange rates, an IMF loan could also help by supporting a currency in crisis from a rapid depreciation.
6 The IMF has evolved to take up rather different roles, by preventing sovereign defaults and by bailing out banks.

Conclusions

The objectives of the IMF are widely misunderstood. In the main, students are still taught that the IMF's role is to provide funds to countries who want to stabilise their exchange rates or to pay for essential imports. This is no longer true. In recent times the IMF's lending seems to be motivated by a desire to create international financial stability. Less charitably, the IMF could be seen as an international banker bailout machine — the fund providing loans to governments who use them at times of crisis to pay off the gambling debts of the too-big-to-fail banks.

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Source: Economics Review

Read the article above and complete the table below, to evaluate the role of the IMF in promoting growth and development:

Benefits of IMF in promoting growth and development	Evaluation: Disadvantages, limitations, short run / long run, winners / losers, depends on..
Financing a current account deficit	
Stabilising a country's exchange rate e.g. Iceland	
Preventing sovereign defaults e.g. Greece 2010	
Financing bank bailouts e.g. Ireland, Latvia & Hungary since 2008	

Non-governmental organisations (NGOs)

A **non-governmental organization (NGO)** is any non-profit, voluntary citizens' group which is organized on a local, national or international level.

- Organisations which are separate from government and are not commercial, profit making organisations.
- Wide range from local community action groups to charities and pressure groups.
- Help economic development:
- Provide direct assistance in the form of project work e.g. Oxfam, Christian Aid, Cafod run projects providing education, digging wells or giving health care assistance.
- Support community based schemes: local control of small-scale projects, self-reliance, using skills available, environmental sustainability.
- Act as pressure groups, lobbying government and other organisations to adapt what they see as pro-development strategies.
- In developing countries, NGOs can be set up by people to benefit themselves e.g. women in village setting up organisation to provide education for children.

Country example: 'Made in Liberia' NGO Liberia
http://www.youtube.com/watch?v=g9b-SYl2nmw
Take notes on aid being used to help business start-ups

Country example: Water Aid working in Ethiopia

Over 40% of the population have no choice but to collect dirty water from unsafe sources. Ethiopia is in the Horn of Africa, where an extended period of droughts, famines and conflicts has had a *serious impact on health and life expectancy.* Many children die before the age of five. 42 million people in Ethiopia don't have access to safe water and over 71 million don't have adequate sanitation. More than 9,000 children die every year from preventable diarrhoeal diseases caused by poor water and sanitation. Most people in Ethiopia make a living through farming. However, without water they cannot grow the crops they need to feed and support their families. Poor roads make it difficult for engineers to reach remote villages and low water tables present additional challenges. We work with local partners that understand local issues. These include regional governments, technical experts and other charities. We also coordinate a country-wide water, sanitation and hygiene coalition, uniting government organisations, donors, the media and private sector to help promote the right to water and sanitation throughout Ethiopia.

In Ethiopia last year we reached:

- 113,000 people with safe water
- 123,000 people with improved sanitation.

http://www.wateraid.org/uk/where-we-work/page/ethiopia

Corporate, patronising and obstructive: what journalists think about NGOs
Guardian, 17/2/15
There's growing media criticism of the aid sector, according to a new report which suggests how the two industries can work better together. The [Aid Industry - What Journalists Really Think] report, published by the [International Broadcasting Trust (IBT)], paints a bleak picture of relations between aid agencies and reporters. Journalists from the BBC, the Mail, the Sunday Times and other media outlets accuse NGOs of neglecting individuals on the frontline of conflict zones to focus on relatively safe refugee camps – as well as exaggerating the scale of disasters to attract donor money. The report refers to recent stories about tax avoidance, government lobbying and political bias.

Ian Birrell, a freelance foreign correspondent with the Daily Mail, Guardian and others, says that NGOs help deliver a "fraudulent" image of Africa as a place of unimaginable poverty and hardship. Tim Miller, former foreign editor at Sky News, calls for greater scrutiny on aid agencies using donations. "The nadir in NGO activity was the tsunami in 2005 when it became apparent that aid money had been raised and no one knew where it was going," he says.

Nevine Mabro, head of foreign news at Channel 4 News, was one of many interviewees to suggest that the media was now more prepared to scrutinise the work of NGOs. "In the past there was perhaps a feeling that they were untouchable because the majority of what they do is good so they weren't worthy of investigation in the way that a big corporation would be," she says. "But I can't think why or when that might have changed. If someone came to me with a story now about corruption [within the aid industry], I would definitely look into it." Among the suggestions to improve, the journalists urge NGOs to be more transparent in their dealings with the press, and to focus on emergency, rather than development aid.
https://www.theguardian.com/global-development-professionals-network/2015/feb/17/media-development-journalism-ngos-report-ibt

Less than 2% of humanitarian funds 'go directly to local NGOs'
Guardian, 16/10/15
Call for funding to reach 20% by 2020 for local agencies which typically take greatest risks and can operate faster and more cheaply. Less than 2% of all humanitarian funding goes directly to local NGOs, despite them taking the lion's share of the risk and often being better placed to deliver, according to aid insiders. Stephen O'Brien, the head of United Nations humanitarian affairs, told a conference in Switzerland that aid delivered by local agencies was often faster, cheaper and more "culturally appropriate". "In Syria, the Arab Red Crescent risked their lives every day to help," O'Brien said. "In west Africa during the Ebola outbreak, community leaders succeeded where international actors had failed to persuade local communities to change traditional burial practices and help to end the transmission of the disease." This exposure meant that about 90% of humanitarian workers who died in 2014 were local staff, he said.

But despite years of discussion about the issue, almost all aid funding continues to flow to the large international agencies; a situation that is increasingly embarrassing for the sector. Figures for how much funding goes directly to local NGOs are hard to find, but the [World Disasters report] puts it at 1.6%. Degan Ali, the head of [Adeso Africa], argued for a target of 20% by 2020. "Local NGOs are taking the risks, are the first responders, are the innovators. But we are persistently sidelined – in Nepal, in Philippines and in a grotesque way in Haiti," Ali told the Guardian, referring to the locations of natural disasters in recent years. Most accounts of international intervention in Haiti after the earthquake in 2010 acknowledge that the big organisations marginalised local NGOs and even stole their staff.

“Without money, without funding, we are so constricted,” Ali said. “We are told persistently that the main issue is risk aversion, accountability, corruption. But you can’t do risk management without funding.” She said one large UN agency would only pay overheads to international NGOs. “How can we build and grow without proper financial support?”

Money, as usual, is the biggest problem. Humanitarian aid depends on regular appeals to donors rather than a steady funding stream, but the intense and demanding conflict work of the last five years has meant the gap between appeals and actual funding has widened.

Manu Gupta, co-founder of the National Alliance for Disaster Risk Reduction in India said “International agents go in and don’t take into consideration the context, the culture. There’s no space for communities to express what they actually need and want. The mindset around this really has to change.”

The bombing of a Médecins Sans Frontières hospital in Kunduz, Afghanistan, this month, in which 10 patients and at least 12 staff died, has thrown light on another issue for the sector: with 75% of humanitarian work now occurring in conflict zones, “how do we protect people in those environments, how do we give them aid?”

Read all the articles above to complete the table below:

Benefits of NGOs in promoting growth and development	Evaluation: Disadvantages, limitations, success depends on…