A Level Economics (EdExcel)
Theme 4: A Global Perspective
Course companion 1:
Factors influencing growth and development




Name:

Tutor group:

Contents

Introduction to growth and development in the global economy

Throughout Theme 4, you will be studying both **developed and developing** countries, you will be required to have an *'awareness of trends in the **global economy** over the last 25 years'*, and must be able to include relevant **country examples** in your analysis and evaluation.

Relevant key terms from Theme 2

Gross domestic product is the sum of all goods and services produced in a country in a year.
Economic growth is the percentage annual increase in real GDP
Nominal GDP - ** GDP in **money terms, valued at current prices, **unadjusted** for inflation.
Real GDP - ** Nominal GDP **adjusted for inflation, valued at constant prices. Real GDP is used to measure growth as it shows whether or not more goods and services have been produced.
Per capita income – This is the total GDP **divided by the population**. It is a better indicator of living standards as it shows the amount of goods and services available per head.
Sustainable development: development which meets the needs of the present generation without compromising the needs of future generations.

Classifying countries
Different classifications focus on:

- stage of development
- income level
- type of economic system
- geographical location
- membership of a group

Newly industrialised countries (NICs): A group of countries that have recently attained a high level of development following a policy of industrialisation e.g. Taiwan, Argentina, Mexico.

First, second & third world countries: based on world pre-1990:
First world: high income/developed
Second world: Communist countries e.g. USSR & Eastern Europe
Third world: Low/middle income

	Developed countries	Transitional economies	Developing countries
Alternative terminology	First world Western industrialised countires	Second world Commonwealth of Independent States (CIS)	Third World Less Economically Developed Countries (LEDCs)
Geographical location	West of northern hemisphere East Asia (Japan) Extreme south east (Australia)	Eastern Europe and Asia	Southern hemisphere
Other	G7 or G8 (USA, Canada, France, Italy, Gernmany, UK, Japan + China)	Former USSR countries	Low income countries Middle income countries Emerging economies Newly Industrialised countries (NICs)

World Bank classifications by real GNI per capita at PPP (purchasing power parity):
Low income: $1,005 or less
Lower middle income: more than $1,006 but less than $3,955
Upper middle income: more than $3,956 but less than $12,235
High income: $12,235 or more
(Data above used by World Bank in 2017-8)

Developed countries: high income countries: A nation that has a high Human Development Index (HDI) and advanced technological infrastructure relative to other less industrialized nations.

Developing countries: middle/low income countries: A nation with a less developed industrial base, and a low Human Development Index (HDI) relative to other countries.

Measures of development

Specification: 4.3.1 Measures of Development
a) The three dimensions of the Human Development Index (HDI) (education, health and living standards) and how they are measured and combined
b) The advantages and limitations of using the HDI to compare levels of development between countries and over time
c) Other indicators of development

Economic development is the process of improving the **economic wellbeing** of a community and **raising living standards**
It measures the **quality** of growth, rather than merely an increase in incomes. In order to measure the quality of growth, we may take into account **access to resources**, **living standards**, the ability to make **choices** & the **sustainability** of growth

Standard of living: The economic well-being of the population including access to necessities and material goods, income, employment, housing, health, education, safety & environmental quality.

“The most basic capabilities for human development are to lead **long and healthy lives**, to be **knowledgeable**, to have access to the **resources** needed for a decent standard of living and to be able to participate in the life of the community.” (UN, HDI)

"Human development, as an approach, is concerned with what I take to be the basic development idea: namely, advancing the **richness of human life**, rather than the richness of the economy in which human beings live, which is only a part of it." (Professor Amartya Sen)

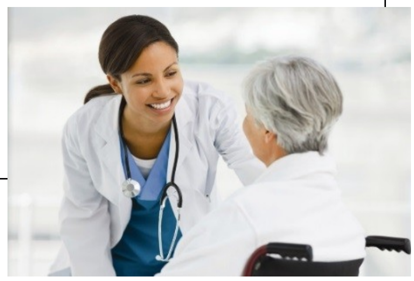
Limitations of using GDP as a measure of standard of living

- GDP figures tell us little about individual people and the quality of their lives
- GDP figures do not include output from work in the hidden economy
- Home produced services are not included, e.g. subsistence farmers in developing economies, DIY
- GDP tells us little about sustainability, e.g. China’s rapid growth does not take into account environmental damage. Development of ‘green GDP’ useful
- It is difficult to value the output of the public sector, e.g. spending on health might be high but with inefficient outcomes
- GDP figures are not as useful as GNP figures which include money flows into and out of the economy

The Human Development Index (HDI)

The HDI is calculated by the **United Nations**. It is used as an indicator of the level of **development** of a country. The HDI was introduced to give a broader definition of well-being than just GDP and provides a **composite measure** of three basic dimensions of human development.

The Human Development Index (HDI) The HDI is a composite index consisting of three dimensions carrying equal weight:
Education: The mean years of schooling for an adult aged 25 and expected years of schooling for a pre-school child.
Health: Life expectancy at birth
Income: real GNI per head at PPPs.



Presented as:

- Index, where the number 1 means the best and 0 is the worst. 1-0.8 is considered to be a high level of human development. Below 0.5 is low
- Rank, where 1 is top & countries get worse as the number rises.

United Nations Human Development Report
Examines current development issues
https://www.youtube.com/watch?v=V9n9IaMpVN8

Note the key findings in the 2018 UN report:

UN Global Goals

http://www.bbc.co.uk/news/world-34440567
Watch the video clip on the UN Global Goals: Take note of the targets being set.
What are the advantages and disadvantages of the UN setting these global development goals?

Other indicators of development

The Inequality-adjusted HDI (IHDI)

- HDI modified to take account of 4^{th} dimension: inequality

- HDI measures of education, health & income adjusted for degrees of inequality.
- The IHDI will be equal to the HDI value when there is no inequality, but falls increasingly below the HDI value as inequality rises.
- The difference between the HDI and the IHDI represents the 'loss' in potential human development due to inequality and can be expressed as a percentage.

The Multi-dimensional Poverty Index (MPI)

- Considers multiple deprivations
- Identifies deprivations across the same three dimensions as the HDI (health, education and standard of living), but collects a broader range of data for each dimension (see table).
- It shows the number of people who are multi-dimensionally poor (suffering deprivations in 33% of weighted indicators) and the number of deprivations with which poor households typically contend.
- It can be deconstructed by region, ethnicity and other groupings as well as by dimension, making it a useful tool for policymakers.
- Not possible to calculate for every country as data not collected/available.

Dimension	Indicators
Health	• Child Mortality • Nutrition
Education	• Years of schooling • School attendance
Living Standards	• Cooking fuel • Toilet • Water • Electricity • Floor • Assets

In addition to the above a variety of other indicators may be used:

• The proportion of the male population engaged in agriculture
• Energy consumption per person
• The proportion of the population with access to clean water
• The proportion of the population with internet access
• Mobile phones per thousand of population.

Table 3 Selected indicators of development

	Multidimensional Poverty Index (MPI)	Inequality-adjusted HDI	Human Development Index (HDI) Value 2013	Life expectancy at birth (years) 2013	Mean years of schooling (years) 2012	Expected years of schooling (years) 2012	Gross national income (GNI) per capita (2011 PPP $) 2013
Norway	-	0.891	0.944	81.5	12.6	17.6	63 909
Chile	-	0.661	0.822	80.0	9.8	15.1	20 804
Mexico	0.024	0.583	0.756	77.5	8.5	12.8	15 854
India	0.282	0.418	0.586	66.4	4.4	11.7	5 150
Zimbabwe	0.41	0.358	0.492	59.9	7.2	9.3	1 307
Mozambique	0.39	0.277	0.393	50.2	3.2	9.5	1 011
Niger	0.584	0.228	0.337	58.4	1.4	5.4	873

Source: adapted from hdr.undp.org/en/data.

With reference to the table above, compare human development in Zimbabwe and Mozambique.

Table 2 Development indicators, 2013

	Ethiopia	Brazil	UK
GNI per capita, US$ at PPP	1 380	14 750	37 970
Internet users (per 1 000 people)	1.9	51.6	89.8
Literacy rate (% of adults aged 15 and over)	n.a.	91	99
Life expectancy at birth, years	64	74	81
Population growth, %	2.6	0.9	0.6
Unemployment, %	5.7	5.9	7.5
Agriculture, % of GDP	45	5.7	0.07
CO_2 emissions, metric tons per capita	0.1	2.2	7.9

Source: adapted from data.worldbank.org.

Using the data, compare the levels of development of Ethiopia, Brazil and the UK.

<u>Benefits and limitations of using HDI to compare levels of development between countries and over time</u>

Benefits of using HDI for comparison	Evaluation: limitations/omissions, disadvantages, depends on…
Between countries	
Over time	

Country example: Equatorial Guinea

Equatorial Guinea

Equatorial Guinea has the highest level of per capita income in all sub-Saharan Africa. Per capita income is twice more than South Africa and nearly the same as Portugal. But three quarters of the population live below the poverty line because inequalities are so great.

The country has everything to be successful. It has big oil reserves, low government debt, fertile land and a small population of less than 800 000 people. However, it is also perhaps the world's best example of the resource curse: instead of creating prosperity, its oil output underpins a dictatorship, fosters corruption and undermines economic development. Human Rights Watch describes the problem bluntly, saying that 'corruption, poverty and repression continue to plague' the nation. 'Vast oil revenues fund lavish lifestyles for the small elite surrounding the president, whilst most of the population lives in poverty, their basic economic and social rights unmet.'

Oil was first produced in Equatorial Guinea in 1995. Oil output rose dramatically over the 10 years to 2005, when it hit a record high of 376 000 barrels per day. Since then, production has declined because of ageing fields and a lack of new discoveries.

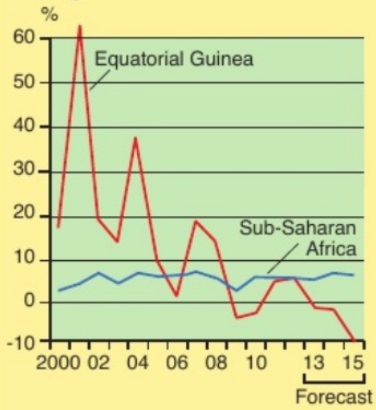
Over the past five years, there has been a burst of public spending. The government has rebuilt airports and roads, and improved electricity and water supplies. But opposition activists say that it has benefited the local ruling class with lucrative government-funded contracts. The country has also spent lavishly on 'prestige' projects, including conference centres, luxury hotels and massive six-lane highways hardly used by the local population. Meanwhile, education and health services remain underfunded.

While the government is spending heavily, little is being invested in ways that would foster long-term development, foreign economists and local activists say. As a result, the economy is expected to contract in 2014. Negative economic growth is an oddity in sub-Saharan Africa where most economies are growing at 5-10 per cent per year.

Source: adapted from © the *Financial Times* 4.2.2015, All Rights Reserved.

Figure 3

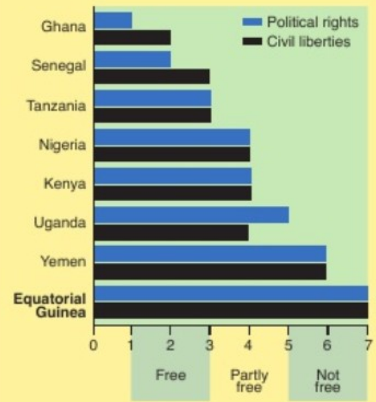
GDP growth



Source: adapted from Freedom House.

Figure 4

Rating on freedom



Source: adapted from Freedom House.

Q

1. Explain why Equatorial Guinea's Human Development Index score is significantly below that of South Africa despite have a GNI per capita which is nearly twice as high.
2. Using the data and your own economic knowledge, discuss whether rises in GNI automatically lead to an increase in the level of economic development of a country.

Evaluation

There is a number of issues here which can be evaluated. For example, is Equatorial Guinea the exception rather than the norm for the link between GNP and economic development? Has there been economic development in Equatorial Guinea but not just as much as one would expect given the very rapid rise in GNI? Over a long period of time, can there be economic development without any increase in GNI?

Table 5 Selected indicators

	Human Development Index (HDI)s	Life expectancy at birth	Mean years of schooling	Expected years of schooling	Gross national income (GNI) per capita
	(value)	(years)	(years)	(years)	(2011 PPP $)
	2013	2013	2012	2012	2013
Portugal	0.822	79.9	8.2	16.3	24 130.0
South Africa	0.658	56.9	9.9	13.1	11 788.0
Equatorial Guinea	0.556	53.1	5.4	8.5	21 927.0

Source: adapted from hdr.undp.org.

Classwork:

1. Distinguish between **growth** and **development**

2. Explain why Equatorial Guinea's Human Development Index score is significantly below that of South Africa despite having a GNI per capita which is nearly twice as high.

3. To what extent might growth lead to development?

Analyse ways in which economic growth might lead to development	 Evaluation: Disadvantages, limitations, depends on…

4. To what extent is it possible to have development without growth?

4.3.2 Factors influencing growth and development

Specification
4.3.2 Factors influencing growth and development
a) Impact of economic factors in different countries:

- Infrastructure
- Education/skills
- Demographic factors
- Volatility of commodity prices
- Primary product dependency
- Foreign currency gap
- Absence of property rights
- Savings gap: Harrod-Domar model
- Capital flight
- Debt
- Access to credit and banking including microfinance

b) Impact of non-economic factors in different countries

1. Infrastructure

Infrastructure: the physical capital used for transportation and communication purposes (roads, railways, airways etc.), the provision of utilities (such as water and electricity supplies) and public services (such as health and education)
Poor infrastructure: Lack of physical capital e.g. transport, telecommunications, energy supply, water supply, waste disposal.

Country example: India
Watch the video clips and take notes on railway & energy problems in India

https://www.tutor2u.net/economics/blog/chinese-and-indian-railways-importance-of-infrastructure

http://www.tutor2u.net/blog/index.php/economics/comments/unit-4-macro-erratic-energy-supplies-threatens-indian-growth

https://www.tutor2u.net/economics/blog/unit-4-macro-indias-energy-deficit-limits-growth?

China and infrastructure in Africa (edited from The Guardian 2016)

Addis Ababa has a surprise in store for those who haven't visited in two years. Cutting through the heart of this booming city, where construction cranes are the most persistent feature of the skyline, is the Addis Ababa Light Rapid Transit (AALRT) network. On the back of the green and white trains that trundle up and down the line are not one, but two logos: the Ethiopian Railways Corporation, and, next to it, the logo of the giant state-owned China Railway Group (CREC).

How did China get involved in developing an African metropolis that westerners tend to associate with famine and death? And this is just one project among many across the continent. In 2014 alone, China signed more than £56bn in construction contracts across Africa. Since the turn of the century, Chinese firms have built stadiums, highways, airports, schools, hospitals and, in Angola, an entire city that still stands empty. China has pumped hundreds of billions of dollars into African governments and infrastructure. In return, it has gained natural resources.

The Light Railway project dates back to December 2011 when the idea for a 34.25km electrified light railway secured funds from Exim Bank of China. Construction for the 39-station project began in 2013 and the metro opened in September 2015, well ahead of schedule. The line has cost $475m, 85% of which was loaned by Chinese policy banks or enterprises.

The metro moves about 15,000 people per line per day and costs about six birr (10p) a ride. But describing it as an outright success would be a stretch. The construction often looks slapdash – a standard complaint about Chinese construction projects across the continent. At St Estfanos station, an empty USAID wheat sack serves as a garbage bag. This serves as a neat analogy of the competing interests in Ethiopia, and also of the different approaches. For the West, the country has always been a basket case, or alternatively, a bulwark against Islamist extremism. For the Chinese, it represents a vast, untapped market: a country of almost 100 million people, 90 percent of whom are unbanked, primed to roar through the remainder of the century as a force in Africa, and beyond.

But there was a second, perhaps even more pragmatic, reason to build the railway. "We have to rely on importing natural resources from other countries," Gau said, seated behind a desk in his large Beijing office. "If China was to keep up sustainable development for many years, China has to secure a supply of natural resources and minerals to feed our industries."

Over the course of the commodities super-cycle, the boom market for natural resources such as oil, steel, gold, manganite and platinum, lasting roughly from the turn of the century to 2013, China and sub-Saharan Africa's economies were effectively coupled: when graphed, they mirrored each other. China purchased raw materials to fuel development at home, while massive state-owned organisations entered the African market, alongside Chinese-made goods and half a million Chinese migrants.

Addis Ababa's light railway, while it hasn't quite made beaten up Lada taxis obsolete, has so thoroughly transformed the city that it counts as a work of urban alchemy. But the social cost may yet prove immense: as Addis expands and explodes, the city's borders push into land belonging to the Oromo people, causing social ruptures and violence. Ethiopia is facing its own muted version of the Arab Spring.

<u>Questions</u>

1. What TYPES of infrastructure is China investing in in Africa?

2. What are TWO reasons for the Chinese investment in African infrastructure

3. Explain how the light railway might enhance economic growth and development in Ethiopia.

4. Discuss the possible drawbacks and limitations of the Chinese infrastructure projects in promoting development

Investment in infrastructure

Draw an AS/AD diagram showing the impact of investment in infrastructure. Explain your diagram.

Poor infrastructure as a limit to growth & development: Analysis & evaluation

Analysis: Explain how poor infrastructure limits growth/development	 Evaluation: Extent of limit to growth/development. Significance? What does it depend on? Possible solutions?
Electricity	
Road / rail, ports/ airports	
Education/ healthcare	
Sewage / water / waste disposal	
IT/mobile phones	

2. Education and Skills

Human capital: the productive skills embodied in human beings. Thus education and training constitutes investment in human capital.

Brain drain: the loss of highly productive workers to other countries. In the context of development, this usually entails the migration of educated professionals from developing countries to the developed world.

Education and skills have long been recognised as important in human development, but countries face many challenges in improving human capital. Basic skills such as literacy and numeracy can improve productivity, social mobility and an economy's international competitiveness which in turn leads to increased incomes and wealth, and ultimately enhanced living standards.

However, civil wars in LEDCs (including **Sudan** – see below) has left many schools and universities abandoned, teacher shortages (and resultant large class sizes) and a lack of classroom resources, all of which hampers the education process:

'South Sudan battles low literacy' and note reasons for & impact of education problems

https://www.youtube.com/watch?v=wcqalFw6FkE&feature=youtu.be

Equally, the pressures faced by families to bring in adequate incomes often results in children being forced to work in 'sweatshops', as in **Bangladesh**, reinforcing the poverty cycle for the next generation:

https://www.youtube.com/watch?v=Z-Dn9AQKFXA&feature=player_embedded

EZY Economics – Specimen Paper (Q5b)

b) Which **one** of the following affects the take-up rather than access to education in developing countries?

- Education is expensive and requires a large amount of funding.
- Families do not have enough money to send their children to school.
- Prevalence of natural disasters prevents children from attending school.
- Families require their children to do labour intensive work on farms.

[1 mark]

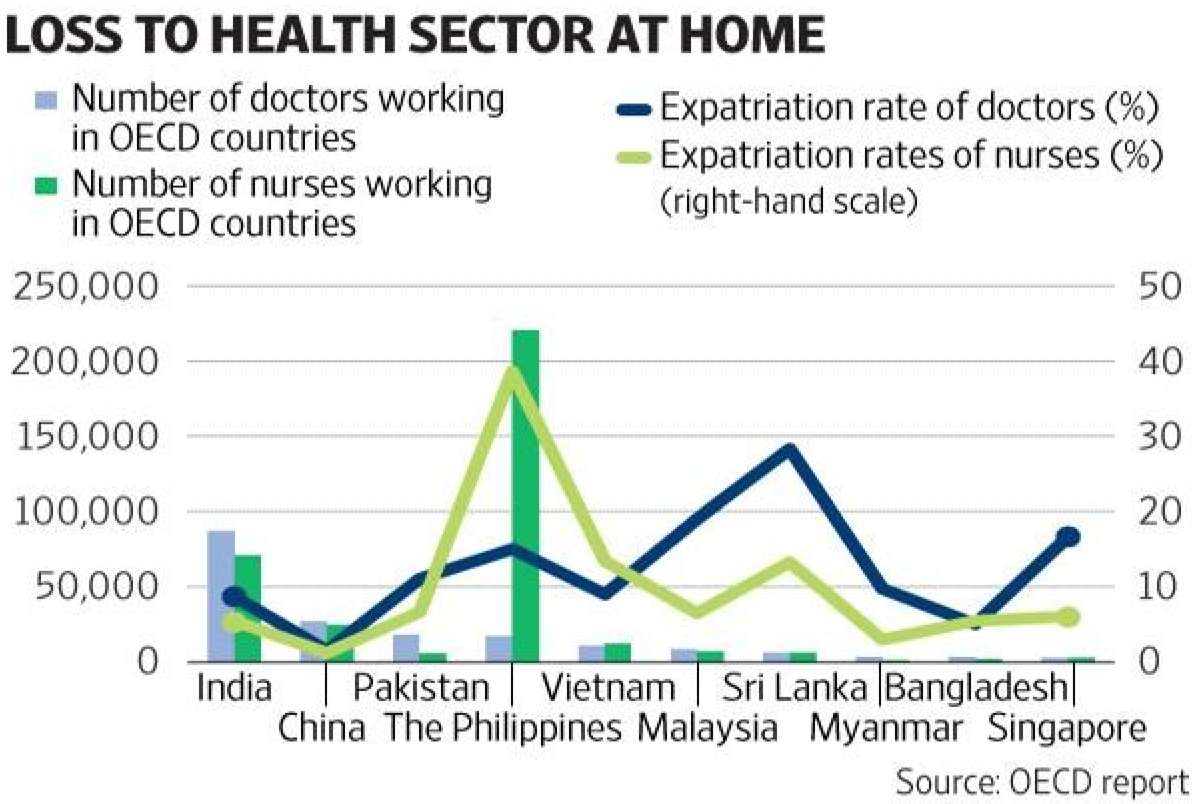
Female education

Class discussion: What might be the particular benefits of good female education?

Country example: India
Where does the educated Indian emigrate to?
Dipti JainRagini Bhuyan, 9/2/16, http://www.livemint.com/Politics/jsOAPZtuPEnXJ8C635mNTK/Where-does-the-educated-Indian-emigrate.html

The overall migrant population of Indian origin in developed countries was 3.6 million in 2010-11, an increase of 83% over the previous decade. But the growth in the population of highly educated Indians was even faster at 123%. At 2.24 million, highly educated Indians are 62% of total Indian origin migrants. This rate is higher than for migrants from other Asian countries such as Singapore (55.8%), Philippines (52.3%) and China (43.8%).
With only about 8% of Indians being graduates, according to Census 2011 numbers, this means that about three out of every 100 highly educated Indians work or study abroad, a rate which has marginally increased between 2000-2001 and 2010-11. The numbers are higher for doctors and nurses with about eight out of every 100 of them migrating to a developed country. Note that as of

January 2015, OECD nations accounted for about one-fifth of the total non-resident Indian population, the migration rate may be even higher including other countries such as the Gulf. Experts say this brain drain highlights the lack of job opportunities that match up to education levels, and underlines concerns over India losing its assets. The numbers have also increased sharply because of a surge in the number of Indians opting for tertiary education.
“India is clearly a huge knowledge economy. The number of professionals produced in different areas is very huge and hence the number of emigrants appears larger.
The OECD report lays particular stress on the migration of health professionals. India saw the highest number of doctors move to OECD countries in 2010-11. Over 86,000 doctors from India were working in OECD countries in 2010-11, with Chinese doctors coming a distant second at just over 26,000. India also had the second-highest number of nurses working in these countries at 70,471.
“India does produce a large number of doctors as compared to other countries. Hence while the total number of doctors moving to other countries is higher, the expatriation rate is quite low,” Thomas added. As of 2010-11, the expatriation rate for doctors from India to OECD countries stood at 8.6%. This is relatively low, especially compared to that of its neighbours Sri Lanka (28.3%), Pakistan (11%) and Nepal (22.3%). India’s expatriation rate for nurses was only 5.4%. China’s, though, was much less (language may play a role in this), with the expatriation rate for both doctors and nurses at only around 1%.



With the health infrastructure already poor in India, the loss of doctors and nurses acts as a double whammy for the country. According to a report by the Indian Council of Medical Research, the doctor-population ratio in India as of 2013 was 1:1800 -- much lower than the World Health Organisation’s (WHO) recommended ratio of 1:1000.

To what extent is the brain drain limiting growth and development in India?

India and education

Comparisons have long been made between India and China. Both are developing countries with large populations and a large land mass. In 1980, it could be argued that both were at similar stages of economic development. Since then, China's performance has outstripped that of India by a large margin. There are many possible reasons for this difference in economic performance, but one is education. In 1980, China had a strong system of state schools. Since then, educational attainment has risen, keeping pace with the needs of its strongly growing economy. In contrast, India's education system has failed to develop sufficiently, leading to too many adults being illiterate. Its education system is hindering the economic development of India and is also impacting negatively on India's economic growth rate.

India in recent years has made significant progress in ensuring access to primary education. In the 1990s, less than 80 per cent attended primary school. Many rural families lived too far from the nearest school to easily send their children, especially girls. Equally, many rural families did not see much value to education because it didn't seem to add any value to their faming-centred lives. In 2002, the government passed a constitutional amendment declaring primary school education a 'fundamental right' for every child aged 6-14. Between 2005 and 2015, 350 000 new primary schools have been built and more than 95 per cent of villages have their own school. Almost every child now goes to school.

However, the quality of education leaves much to be desired. The national curriculum assumes that students will learn to read in their first year of school. This simply isn't happening. Part of the problem is absenteeism. Nearly all children may be enrolled at a school but their attendance can be erratic. Too many parents keep their children off school when there is work to be done on the family farm or in the family business. Teachers too are frequently absent. Surveys indicate that 15-25 per cent of teachers are absent on any given day. Teachers are on salaries and are not particularly held accountable if they fail to turn up to teach.

The result is low standards. According to the 2014 Annual Status of Education Report, a survey of 650 000 children organised by the non-government Pratham Education Foundation, more than half of rural India's fifth-year students cannot read a simple story from a year two textbook, while nearly 20 per cent of second year students cannot recognise numbers up to 9. Worryingly, results have declined considerably since the assessments began in 2005. Pratham estimates that, over the past decade, 100 million children completed primary school without attaining basic reading and maths skills. In 2009, India ranked 73 out of 74 countries in the OECD's triennial test of reading, maths and science skills of global 15-year-olds. India has refused to take part in subsequent OECD tests.

Poor education harms economic development. Part of that harm occurs because it impacts on jobs prospects. For the next stage of India's economic development, millions of people need to move from agricultural employment into secondary and tertiary industries. Most newly created jobs are in services, which require basic literacy and numeracy. Young people who lack these fundamental skills are likely to wind up in employment that barely pays enough to survive and keeps them in poverty.

Source: adapted from © the *Financial Times* 8.5.2015, All Rights Reserved.

Figure 2

India: percentage of pupils from the relevant age group completing primary school

Source: adapted from World Bank.

Table 4 India and China: GNI per capita at current prices, US$ (Atlas method)

GNI per capita at current prices (Atlas method) US$		
	1980	2 013
China	220	6 560
India	270	1 570

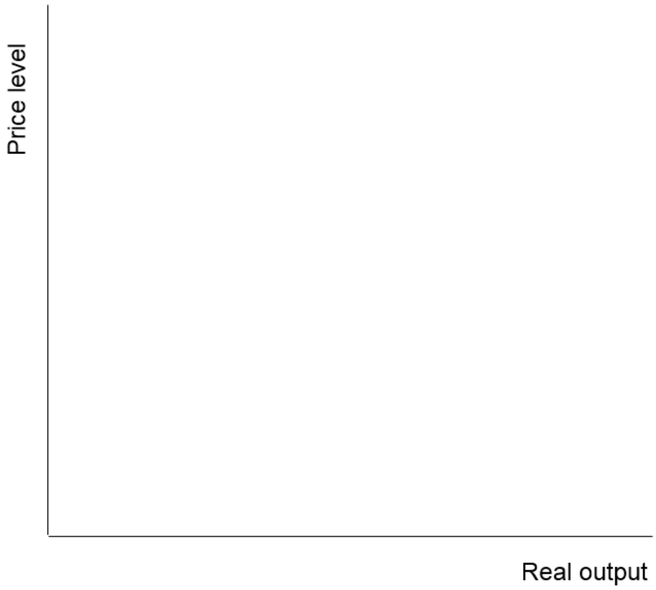
Source: adapted from data.worldbank.org.

Questions

1. Read the article and study the data to complete the table below:

Strengths/improvements in India's education provision	time to evaluate Weaknesses

AD/AS diagram and PPF for government spending on education
On the axes below, draw an AD/AS (left) and a PPF (right) diagram to show the impact of increased government spending on education. Explain your diagrams.



Education & skills: Analysis & evaluation
Discuss the benefits of more state spending on education, as a way of promoting growth & development:

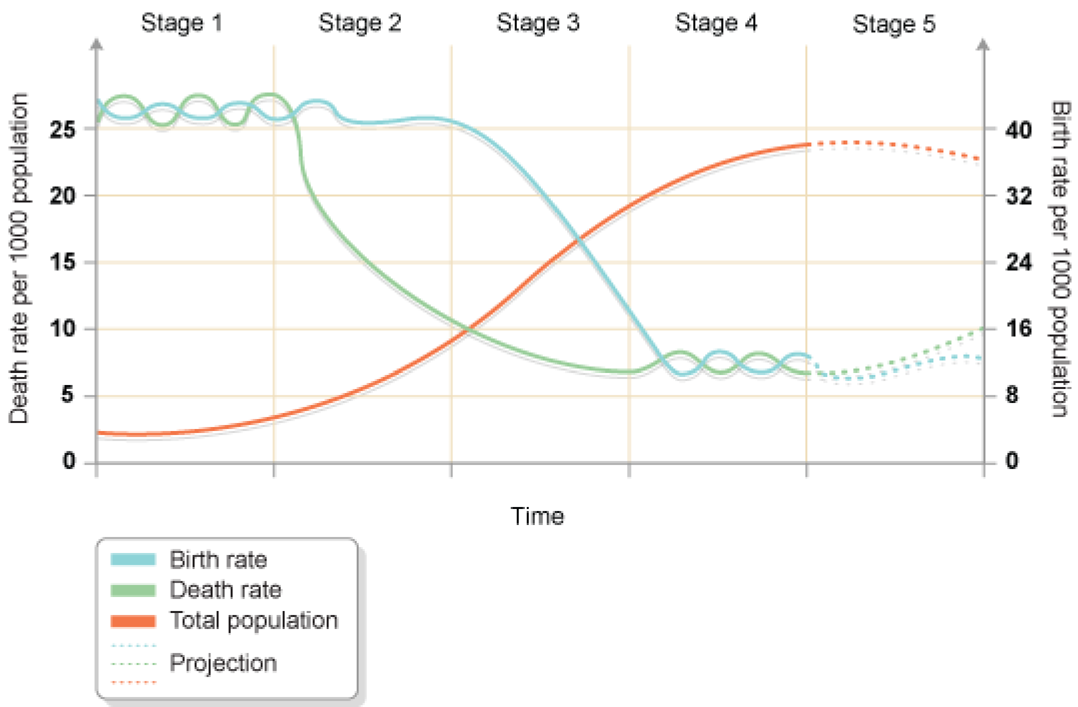
Benefits of education to promote growth / development	 Evaluation: Disadvantages/limitations, depends on…

3. Demographic factors

Demographic transition: Typical changes in population growth rates over time as a country becomes more developed, due to changes in birth and death rates:

1. Population growth is low with high birth rates and death rates.
2. Population growth rises as death rates fall due to improvements in healthcare and sanitation, whilst birth rate remains high.
3. Population is still rising rapidly. The gap between birth and death rates narrows due to the availability of contraction.
4. Population growth slows with a low birth rate and a low death rate.
5. Population is starting to decline due to an ageing population and low birth rate.

Dependency ratio: The ratio of dependent population (the young and the elderly) to the working age population.



The demographic transition model

Clip from the Economist – changing shape of global demographics

https://www.tutor2u.net/economics/blog/global-population-and-the-changing-shape-of-world-demographics

Country example: Nigeria

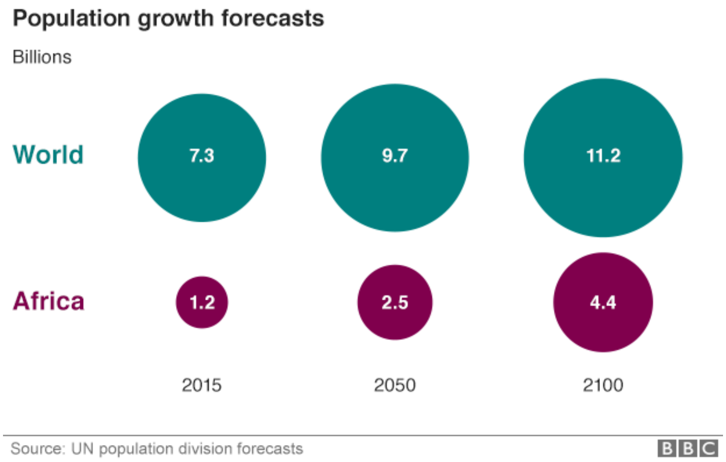
How will a population boom change Africa? BBC News, 11 Sept 2015

The United Nations estimates that Africa's population will double to 2.5 billion by 2050. About 400 million of these people will live in Nigeria alone.

John Wilmoth is, director of the population division of the United Nations.

There's been a substantial reduction in the death rate in Africa, like in other parts of the world, and this is good news in many ways - children survive in much greater numbers to adulthood and adults survive to old age. However, what's preventing that kind of movement in a similar direction to what's happening in the rest of the world is our continued levels of high fertility. You always have three things together: you have high fertility, rapid growth and young populations. Currently in Africa we estimate that 41% of the population is under the age 15. This is a very high fraction. Another 19% are between ages 15 and 24. So if you add those two together you've got three-fifths of the population that is under the age of 25. We really need political will at the highest levels paying attention to this issue because it really will affect the ability of those countries to raise the standard of living for their populations.

We must improve infrastructure and create jobs



Obadiah Mailafia, former deputy governor of the Central Bank of Nigeria and former presidential adviser.

If you go to many of our cities these days they're much more crowded than ever. So huge challenges are deriving from the population increase, and it is quite palpable. You could see it not only in heavy traffic, but also pressure on social services, the water, electricity, schools and the rest of it. From an economist's point of view, it's often the case that increase in population is synonymous with increase in GDP, because you have more labour force, more consumption, more spending. So it tends to be reflected in an overall rise in GDP. But in this day and age quantitative growth is not enough. It's not the ultimate indicator of better conditions for citizens. In some of our biggest airports, there is now pressure on space for parking of private jets. And yet the streets are booming with poor people, people hustling in the streets because they have no opportunities and no hope for the future. My worry is the fact that we are not making arrangements to cater for this rising population. There's no country in the world that I know of that has over 70 million people that does not also have a flourishing rail network. The roads are cluttered up with heavy trucks. And also expanding social services like health, education and the rest of it, all those things need to be in place, together with better planning for population and for families. We must create jobs, we must expound opportunities for young people to get them engaged and busy, otherwise we might find that the sort of thing that happened in the Arab Spring could happen in Nigeria."

Population growth isn't the problem - extreme poverty is

Hans Rosling, professor of international health at the Karolinska Institute in Sweden and perhaps the world's best-known statistician.

What is difficult for the surrounding world is to realise that Africa will become a much more important part of the world. And I see that because so many big investment banks invite me to come and lecture because they see, 'Wow! There's economic growth in Africa. Wow! Companies in Africa are profitable today.' They see customers. The reason the population is growing in Africa is the same reason that [saw] population growth first in Europe, then in the Americas, then in Asia. It's when the population goes from a phase where you have many children born and many who are dying. Then the death rate goes down and [some time later] the birth rate follows. We have a possibility that Africa will repeat what Asia did: a very fast transformation where once you had education, you had child survival and parents saw the options of a better life for their children, they [would] choose to have two or three. And that is happening in Africa; in fact it's already happening among the better-off in Africa. Addis Ababa (the capital of Ethiopia) has 1.6 children per woman, which is less than London. So when you hear an average of Africa of 4.5 children per woman, that is composed by the most modern part of Africa with two children per woman [or less] and the still worst-off, in very extreme poverty, with six to seven. If you continue to have extreme poverty areas, where women given birth to six children, and the population doubles in one generation, then you will have problems. But it's not the population growth that is the problem - it's the extreme poverty that is the underlying reason.

Watch the clip and make notes on the link between population growth and poverty reduction

https://www.youtube.com/watch?v=KUY4ztwIVfA

Impact of demographic issues on growth & development: Analysis & evaluation

Young/rapidly growing population

Challenges/limits to development	 Evaluation: Benefits/policy solutions/what does success depend on?

4. Volatility of commodity prices

Relevant key terms from Theme 1

Price elasticity of supply: a measure of the responsiveness of quantity supplied to a change in price.
PES = percentage change in quantity supplied / percentage change in price

Price elasticity of demand measures the responsiveness of changes in quantity demanded to changes in price.
PED = percentage change in quantity demanded / percentage change in price

Total revenue = price x quantity sold

Market failure where resources are inefficiently allocated due to imperfections in the working of the market mechanism, i.e. when **the price mechanism** causes an **inefficient allocation of resources.**



Commodity markets: These are markets concerned with raw materials, such as precious metals and minerals, and agricultural products.

Hard commodities are natural resources that are mined or extracted.

Soft commodities are agricultural products or livestock.

Producers of manufactured goods can differentiate (make different) their products from those of competitors but commodities tend to be undifferentiated (uniform/homogenous).

Many commodities are traded worldwide and have one international price.

The price elasticity of demand (PED) for many commodities tends to be inelastic (especially in the short run), why?

The price elasticity of supply (PES) for many commodities tends to be inelastic (especially in the short run), why?

1. The Impact of an increase in the supply of wheat (a good harvest)

(a) Draw a supply and demand diagram to show the impact of an increase in the supply of wheat, caused by favourable weather conditions creating a good world harvest.
Take care to show PES and PED **inelastic** and label your diagram fully

The market for wheat

Price

Quantity

(b) Annotate your diagram to show the old and new total revenue

(c) Comment on changes in:

(i) Price

(ii) Quantity sold

(iii) Total revenue

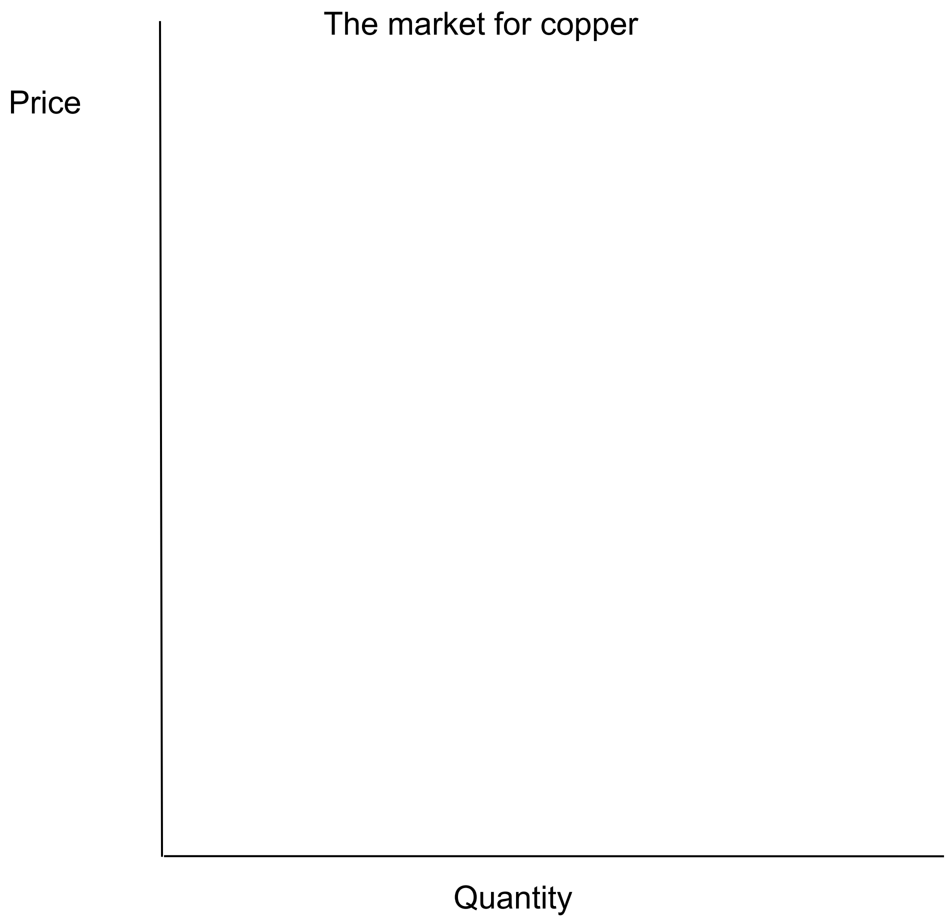
(iv) How might this effect export revenues for a country which exports wheat?

(v) How might this effect the country's current account of the balance of payments and GDP?

2. The Impact of a fall in demand for copper

(a) Draw a supply and demand diagram to show the impact of a fall in demand for copper, caused by reduced construction of infrastructure in China.

Take care to show PES and PED **inelastic** and label your diagram fully



b. Annotate your diagram to show the old and new total revenue
c. Comment on changes in:

(i) Price

(ii) Quantity sold

(iii) Total revenue

(iv) How might this effect export revenues for a country which exports copper?

(v) How might this effect the country’s current account of the balance of payments and GDP?

Country example: Zambia
Copper price close to six-and-a-half-year low, (BBC, 29 September 2015)

The price of copper dropped almost 2% on Tuesday and is close to its lowest level in six and a half years. The metal fell to $4,955 a tonne, just $100 above the level it reached in 2009 in the wake of the financial crisis.
Demand for copper, which is used across industry from construction to car manufacturing, has suffered from the slowing Chinese economy.
Investment bank Goldman Sachs warned investors this week that prices would continue to fall. In a note entitled, "Copper's bear cycle still has years to run", its analysts predicted copper prices would probably drop to $4,800 a tonne by the end of December and to $4,500 by the end of next year. The decline in copper is only a part of a global meltdown in commodity prices caused by China's economic downturn.
The depth of the slump was emphasised on Monday when shares in commodities trader and miner Glencore dived 30%. Four years after the group went public in the UK's biggest stockmarket flotation, analysts at Investec warned that weak commodity prices could lead to the firm's equity value being "eliminated".

Crude oil has fallen some 60% from June last year, thermal coal has been on a long 60% slide since 2011, and iron ore is down even more, close to 70% since 2010. The effects are rippling out into other sectors. On Tuesday, Japanese shipping business Daiichi Chuo Kisen Kaisha filed for protection from creditors, caused by the collapse in Chinese demand for iron ore and coal. Unsurprisingly the collapse sent a shiver through the rest of the Japanese shipping sector. Nippon Yusen, Mitsui OSK Lines, Kawasaki Kisen Kaisha saw their shares fall between 4% and 8%.
And the effects spread far wider than the mining companies and their support services. Any economy dependent on commodity exports is seeing its currency punished. Australia, whose iron ore, coal, oil and natural gas fuelled the Chinese boom, has seen its dollar lose more than a quarter of its value against the US dollar over the past year. Chile, where copper makes up 30% of the value of its exports, is expected to announce on Tuesday that public spending, having grown almost 10% last year, will rise by half that amount this year. Economic growth there has slowed along with the fall in the copper price and a decline in investment in the mining sector.

For smaller countries the effect can be catastrophic. On Monday, Zambia's currency, the kwacha, fell more than 17% - its biggest one-day fall on record - as prices for its copper exports dived again. Copper accounts for 85% of the country's exports. The currency recovered on Tuesday but it is down 45% on the year. It has also been hit by the news that Glencore, the country's second largest employer after the government, might make further cuts at its Mopani Copper Mines there. Last week, it announced it would lay off more than 3,800 workers. Ratings agency Moody's cut Zambia's sovereign rating on Friday, making it more expensive to borrow in the international markets.

Questions:

1. Using a supply and demand diagram, explain the reason for the fall in the price of copper.

2. Describe the impact of the fall in copper prices on mining companies.

3. What has happened to the exchange rate value of the Zambian currency, the Kwacha? How might this affect the Zambian economy?

Venezuela, cursed by oil

(http://www.panoramas.pitt.edu/economy-and-technology/venezuelas-case-dutch-disease-cursed-oil)

Global oil prices are plummeting and they are falling fast. As a result, Venezuela, which has the world's largest known crude oil supplies, is left with an economy that is barrelling out of control. On January 22, Venezuela's oil price fell to $21.50 a barrel, compared to over $100 a barrel in 2014 (Yahoo News, 2015). As prices continue to fall, Venezuela's surplus of oil stocks grow. Rising oil surplus, however, does not translate into food, medical supplies, and political and domestic stability in Venezuela, as President Maduro is quickly finding out. A country rich in one of the world's most demanded natural resources, Venezuela is riddled with poverty and instability, having been cursed by the resource upon which it depends so deeply.

In 2013, of Venezuela's $143 billion in exports, $139 billion were comprised of crude and refined petroleum (Observatory of Economic Complexity, 2013). Petroleum in Venezuela accounts for 96 percent of export earnings, about 40 percent of government revenues, and 11 percent of GDP (CIA World Factbook, 2015). Such a heavy dependence on one natural resource means that when world oil prices plummet, Venezuela's economy crashes. Economists know that commodity prices continuously fluctuate, and as such, economies need backup industries that can sustain the economy when natural resource prices fall. More often than not, a country high in exports of natural commodities is found to be low in economic growth rates. Venezuela is no exception to this paradigm.

How could Venezuela have avoided its recent problems?

Why commodity prices are surging (Economist 11.1.2018)

THE strong performance of the world’s economy is finally filtering into commodity prices. Last year will probably turn out to have been the first year since 2010 in which growth accelerated in each of America, Europe, China and Japan. And Brent crude oil, copper and a Bloomberg composite index of spot prices for 22 raw materials are all at their highest levels since November 2014. But if global demand has been picking up for several quarters, why has it taken this long to become evident in commodity prices? And more importantly, how sustainable is the rally?

The delay in the price increases is the easiest part to explain. Years of strong production of oil, base metals and grains left the global economy with huge surpluses. Stockpiles of oil reached a record high in November 2015, according to the International Energy Agency. OPEC, the oil cartel, agreed to restrain production in order to drain the surpluses and eventually put prices under upward pressure. China also applied the same principle to certain sectors. In 2016 it cut the number of working days for coal miners from 330 to 276, and cut its steel output by 65m tonnes. These measures appeared to have little effect at first, but now that strong demand has eaten into those reserves, prices are rising.

The rally’s likely length is trickier to assess. The short-term outlook for the global economy is highly encouraging. The American economy continues to create jobs at a rapid rate, and businesses there are confident about the probable impact of President Donald Trump’s tax cuts. European manufacturers are also buoyant. The Chinese economy proved so resilient to tighter credit conditions in 2017 that some of those capacity cuts were reversed. Furthermore, other emerging markets that have struggled in recent years, notably Russia and Brazil, are growing again. It appears likely that the global economy will grow as quickly in 2018 as it did in 2017. This will generate higher demand for commodities.

But in the longer term, prices may weaken. After all, oil prices have only risen above $60/barrel thanks to OPEC’s emergency production-cutting measures. When the agreement ends at the end of the year, and the cartel’s members are again allowed to pump at will, supply will jump and prices will fall. And if OPEC’s strategy proves more successful than expected and prices continue to climb, then American shale producers will drill faster to exploit greater profitability. China can continue to unwind its capacity cuts or invest in new, greener production if prices become too hot. In agricultural markets, there are no cartels like OPEC to bring producers together to negotiate output cuts. Consequently, excellent recent harvests of the most widely consumed grains and seeds—wheat, maize, soybeans—have kept a lid on prices. And stocks are still bulging, so any price increases arising from freezing weather across North America at the beginning of 2018 will be temporary. Even after years of commodity producers limiting their output to support prices, they should be wary of loosening their belts too quickly.

Questions:

a. What is the main cause of rising commodity prices?

b. Why has the rise in prices lagged behind global growth?

c. Why are grain prices so volatile?

d. Why are oil prices likely to fall again?

Summary: Analyse and evaluate the impact of the volatility of commodity prices on growth AND development

Problems of volatile commodity prices for growth / development	 Evaluation: are all producers / economies equally affected? What does impact depend on? Possible solutions?

5. Primary product dependency

What is Primary product dependency?

The heavy reliance on a narrow range of products, often commodity products e.g. coffee. The commodity/commodities account for:
a large % of **employment**, a large % of **GDP** and/or a large % of **exports**.

Theory concerning the problems caused by primary product dependency

Commodities and natural resources should bring economic growth and development to those countries with abundant natural resources. However, there are a number of reasons why having an abundance of natural resources might lead to a **resource curse.** These reasons include:

i. Fluctuating commodity prices

As we have already learnt, **volatile commodity prices** create problems for countries such as Zambia which are primary product dependent. Why?

ii. The Dutch Disease

Dutch disease is the negative impact on an economy of anything that gives rise to a sharp **inflow of foreign currency**, such as the discovery of large oil reserves. The currency inflows lead to **currency appreciation**, making the country's other products less price competitive on the export market. It also leads to higher levels of **cheap imports** and can lead to **deindustrialisation** as industries apart from resource exploitation are moved to cheaper locations. (ft.com)

The Economist coined the term in 1977 to describe the woes of the Dutch economy. Large gas reserves had been discovered in 1959. Dutch exports soared. But, we noticed, there was a contrast between "external health and internal ailments". From 1970 to 1977 unemployment increased from 1.1% to 5.1%. Corporate investment was tumbling. We explained the puzzle by pointing to the high value of the guilder, then the Dutch currency. Gas exports had led to an influx of foreign currency, which increased demand for the guilder and thus made it stronger. That made other parts of the economy less competitive in international markets. That was not the only problem. Gas extraction was (and is) a relatively capital-intensive business, which generated few jobs. And in an attempt to stop the guilder from appreciating too fast, the Dutch kept interest rates low. That prompted investment to rush out of the country, crimping future economic potential. (Economist.com)

The Dutch Disease has been linked to a number of developed countries such as the UK, Netherlands, Australia, it has also been diagnosed as the cause of problems for oil-rich developing countries such as Venezuela and Angola.

a. Use a diagram to show a rise in the value of the Australian $ caused by the increase in the demand for the currency due to its booming exports of coal, metals and other commodities.

b. What is meant by the term 'deindustrialisation'?

iii. The Prebisch-Singer hypothesis

This theory, put forward in the 1960s suggests that **the terms of trade between primary products and manufactured goods tend to deteriorate over time**

Terms of trade = average price of exports/average price of imports

The theory suggests that countries that export commodities would be able to import less and less for a given level of exports. Prebisch and Singer observed that over time the terms of trade for primary commodity exporters did tend to decline.

The hypothesis was based on the collection of data by Prebisch and Singer on export prices of different types of goods over a period of time.

A common explanation is that the demand for commodities is income inelastic so demand will not rise as the world gets richer and the demand for manufactured goods is income elastic so demand will rise as the world gets richer. Therefore, as income rises, the demand for manufactured goods, e.g. cars, washing machines and computers rise relative to the demand for primary products, e.g. cocoa and coffee, so causing a decline in the terms of trade for countries dependent on export of primary products compared to exporters of manufactures.

a) Show the calculation for the income elasticity of demand:

b) If demand for agricultural goods is income inelastic, as world income rises the demand for food will ______________ and the prices of agricultural goods will _____________

c) If demand for manufactured goods is income elastic, as world income rises the demand for food will __________ and the prices of manufactured goods will _________

d) Define the terms of trade

e) If a developing country exports agricultural goods and imports manufactured goods, explain what will happen to the terms of trade over time:

What are the implications of the Prebisch Singer hypothesis for countries with high export dependence on primary products?

Such countries stand to lose out from a worsening of the terms of trade. This is because they will have to import a greater quantity of exports to pay for essential imports such as raw materials, consumer goods and capital goods.

The PSH suggests that when such countries gain from high world commodity prices, this may be temporary and threaten the macroeconomic stability of such countries – e.g. a fall in world demand and prices for a primary commodity will cause a rise in the trade deficit and the fiscal deficit for an exporting country

Based on the PSH, the advice for these countries is to use revenues from primary commodity exports to fund education, the development of skills and expand technological capacity. Developing manufacturing capacity and greater **diversity** of output is also important.

Evaluation of the Prebisch-Singer hypothesis

The natural **resource curse** is a more general concept concerning the primary product dependency of developing countries. Countries blessed with an abundance of natural resources can struggle to make best use of them and often end up with lower levels of development e.g. Venezuela, Angola, and Nigeria. Other countries which are resource poor, such as Japan and Switzerland may end up with a much higher level of development.

Some countries have benefitted from an abundance of natural resources, e.g. Malaysia

http://www.tutor2u.net/blog/index.php/economics/comments/unit-4-macro-perspectives-on-natural-resource-curses

However, **problems** may arise due to:

a. Civil war over ownership of resources

Paul Collier claims that a ‘curse’ arises due to the internal conflicts arising over ownership of the resources. Groups fighting a civil war need money and use natural resources. Collier suggests the quality of a resource can influence the passage of a war. In Angola, the rebel organization UNITA drew its funding from trade in gold, timber, wild animals and diamonds. The Angolan government had access to the major oilfields while UNITA funded its war from the revenue from the diamond mines. During the 26 years of civil war, both sides profited from unhindered access to the revenues from the extractive industries. Collier suggests the success of the war matched the prices of oil and diamonds.

b. A lack of investment in other industries

c. A rise in the value of the currency (Dutch disease)

d. Low income elasticity of demand and declining terms of trade (P-S hypothesis)

e. Large multinationals owning rights to natural resources and exploiting them with profits going to overseas shareholders and little local employment

f. Corruption developing within the government and other institutions to ensure private gain

Commodities alone are not enough to sustain flourishing economies (Economist 9.9.2010)

IT MAY seem a safe bet that billions of Asians will continue to gobble up oil, iron ore, copper, soyabeans and meat as they get richer. But one day they may not; and one day, too, the world will surely come up with alternatives to fossil fuels that emit less carbon. Indeed Brazil already has, in the form of ethanol from sugar cane, and Colombia and Central America are following suit.

Latin America is uncomfortably dependent on commodities. In the past decade they accounted for 52% of the region's exports, according to the World Bank. That is down from 86% in the 1970s, but over the same period the figure in East Asia and the Pacific fell from 94% to 30%. Chile, Peru and Venezuela still rely on raw materials for more than three-quarters of their total exports. In all, as the World Bank notes in a report published this month, more than 90% of Latin Americans live in countries that are net exporters of commodities, the exceptions being in Central America and the Caribbean. Governments have also become more reliant on raw materials for their tax revenues (see chart 1).

There is nothing wrong with producing raw materials. The rise in world prices for Latin America's commodities, and the related increase in their output, may have accounted for between one-third and half of the region's growth over the past decade. And thanks to Asia's economic vigour, commodity prices fell only briefly during the recession and remain at historically high levels. Over the past decade a region that has habitually suffered from balance-of-payments troubles has benefited from the foreign exchange that commodities bring in. This bonanza seems to refute the thesis put forward by Raúl Prebisch, that the price of commodities is bound to decline in relation to the price of manufactured goods.

Even so, relying on raw materials carries a series of risks. One is volatility: their prices are more variable than those of manufactures. Second, many economists worry about “Dutch disease”. This malady involves commodity exports driving up the value of the currency, making other parts of the economy less competitive, leading to a current-account deficit and even greater dependence on commodities. This matters all the more because mining and hydrocarbons are capital-intensive businesses, generating relatively few jobs.

The commodity boom, together with capital inflows attracted by better economic prospects, has already pushed up the value of some of the region's currencies. For example, São Paulo seems extraordinarily expensive to any visitor. The strength of the Brazilian currency, the real, worries officials and industrialists.

A third concern is that many non-agricultural commodities are not renewable (although high prices encourage new discoveries), so governments should invest the tax revenues they generate in infrastructure and training to diversify the economy. Producing commodities may also involve local environmental damage. In parts of Latin America mines and oilfields are in areas inhabited by people of indigenous descent and have caused cultural clashes.

A fourth problem is the potentially corrosive effect of commodity production on political institutions. Many commodities incorporate rents (ie, excess profits derived from the fact that supply is usually limited in the short term). It is in the state's interest to capture those rents, but corruption often follows when it does. Venezuela provides the clearest evidence of these ills.

a. Explain the problems caused for countries where the government tax revenue is largely reliant on natural resources

b. What are the possible negative externalities caused for local communities by the exploitation of natural resources?

Would Nigeria been better off without oil?

In the October 2007 edition of econoMAX I wrote a piece comparing the oil rich nations of Nigeria and Norway – "Chalk and Cheese". Further research into Nigeria shows how desperate the state of the economy is in and one wonders if they would be better off without oil.

Nigeria, the eleventh largest producer and the eighth largest exporter of crude oil in the world, typically produces over 2.4 million barrels per day (b/d) of oil and natural gas liquids. However, according to the IMF, while the Nigerian economy has benefited $800 billion dollars in oil revenue since 1960, this has added basically nothing the Nigerian economy or the standard of living of the average Nigerian. In fact the World Bank estimates that since 1960 $100 billion of the $800 billion in oil revenues have gone missing.

Further research suggested that 85% of this oil revenue finds its way to only 1% of the population with some 40% being stolen. From 1965-2004 per capita income fell from $250-$212 and the number of people living on less than one dollar a day in Nigeria grew from 36% to more than 70%, from 19 million to a staggering 90 million. It is therefore not surprising to notice that, since 2000, its Human Development Index (HDI) (see below) has fallen to 0.423 and Nigeria is now ranked at 142 out of 169 countries. It is on a par with the likes of Congo and Haiti.

Human Development Index – measurements.

1 Life expectancy at birth

2 Education – a weighted average of adult literacy (two-thirds) and average years of schooling (one third)

3 Real GNP per capita – measured in US dollars, at purchasing power parity* (PPP) exchange rates.

A different "Resource Curse"

For most economies that have natural endowments like oil or minerals, there is the risk of the economy experiencing the 'resource curse'. This is when a natural resource begins to run out, or if there is a downturn in price, manufacturing industries that used to be competitive find it extremely difficult to return to an environment of profitability.

According to Paul Collier, Nigeria has a resource curse of its own, the **civil war trap** in which 73% of the low income population have been affected by it, as well as a **natural resource trap** - where the so-called advantages of a commodity in monetary value did not eventuate - on average affecting only 30% of the low income population. It seems that in Nigeria there is a strong relationship between resource wealth and poor economic performance, poor governance and the prospect of civil conflicts. The comparative advantage of oil wealth in fact turns out to be a curse.

Nevertheless, it is the feasibility of plundering by governments and insurgent groups that determines the risk of conflict, not the ethnic or religious diversity. Others see oil as a "resource curse" due to the fact that it reduces the desire for democracy. This can happen through lower taxes and high patronage as well as government having control over oil revenues, which maintain military and security expenditures.

Final thought

'First Law of Petropolitics': "the higher the average global crude price of oil, the more free speech, free press, fair elections, an independent judiciary, the rule of law and independent political parties are eroded." Thomas Friedmann

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Crude Politics: Life and Death on the Nigerian Oil Fields – Michael Watts University of California Berkeley. 2009

Oil and the Economics of Civil War

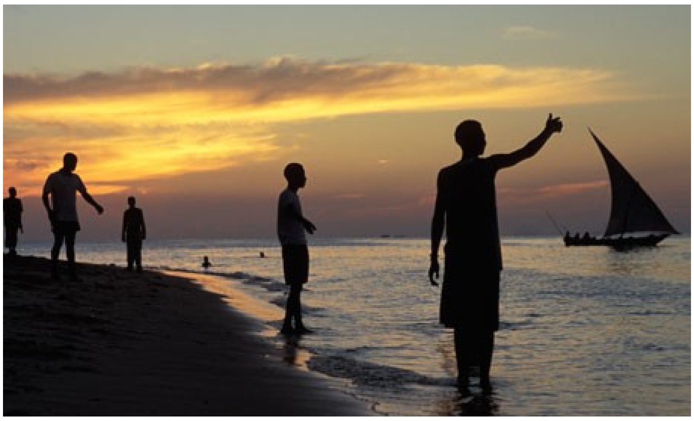
The dependence on oil in an economy can act as a catalyst to the rise of insurgent activity and "petro-regimes". In Nigeria, for example, oil rents have historically prolonged a 'bloodsucking' ruling elite, and provided the finance for the state to purchase a sort of political authorisation among the oil producing regions. Paul Collier sees oil as central to the economics of civil war. It encourages extortion and looting through resource plundering and he identifies that it is most prevalent where the resource itself accounts for at least 26% of country's GDP. Where it is below this figure insurgent and corrupt activity tends not to be as widespread.

Country example: Nigeria

Read the article 'Would Nigeria be better off without oil?' and explain how dependency on oil has limited growth & development

Africa's natural resources can be a blessing, not an economic curse

(Stiglitz, Guardian 2012)



Resource-rich countries have, on average, done poorly but progress is possible if they get economic and political support.
People in countries rich in natural resources, such as Tanzania, can benefit if given the right political and economic support. New discoveries of natural resources in several African countries – including Ghana, Uganda, Tanzania and Mozambique – raise an important question: will these windfalls be a blessing that brings prosperity and hope, or a political and economic curse, as has been the case in so many countries?
On average, resource-rich countries have done even more poorly than countries without resources. They have grown more slowly, and with greater inequality – just the opposite of what one would expect. After all, taxing natural resources at high rates will not cause them to disappear, which means that countries whose major source of revenue is natural resources can use them to finance education, healthcare, development and redistribution.
A large literature in economics and political science has developed to explain this "resource curse", and civil-society groups have been established to try to counter it. Three of the curse's economic ingredients are well-known:

• Resource-rich countries tend to have strong currencies, which impede other exports
• Because resource extraction often entails little job creation, unemployment rises
• Volatile resource prices cause growth to be unstable, aided by international banks that rush in when commodity prices are high and rush out in the downturns (reflecting the time-honoured principle that bankers lend only to those who do not need their money).

Moreover, resource-rich countries often do not pursue sustainable growth strategies. They fail to recognise that if they do not reinvest their resource wealth into productive investments above ground, they are actually becoming poorer. Political dysfunction exacerbates the problem, as conflict over access to resource rents gives rise to corrupt and undemocratic governments.

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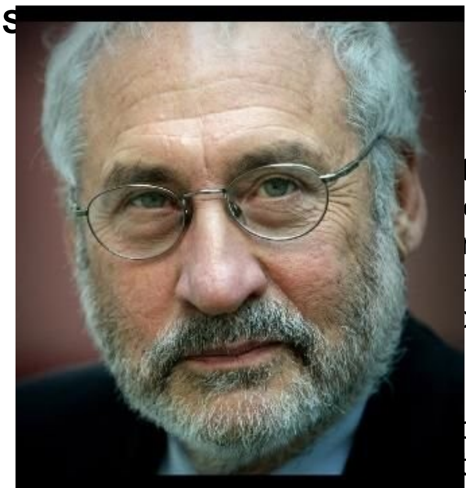


t do more to ensure that their citizens get the full value of the
many countries have already signed bad contracts that give a
he resources' value to private foreign companies. But there is a
e; if that is impossible, impose a windfall-profit tax.
ney gained through natural resources must be used to promote
nial powers regarded Africa simply as a place from which to
f the new purchasers have a similar attitude.

ads, and ports) has been built with one goal in mind: getting the
ry at as low a price as possible, with no effort to process the
resources in the country, let alone to develop local industries based on them.

4. Real development requires exploring all possible linkages: training local workers, developing small- and medium-size enterprises to provide inputs for mining operations and oil and gas companies, domestic processing, and integrating the natural resources into the country's economic structure. Of course, today, these countries may not have a

comparative advantage in many of these activities, and some will argue that countries should stick to their strengths. From this perspective, these countries' comparative advantage is having other countries exploit their resources.

Resources should be a blessing, not a curse. They can be, but it will not happen on its own. And it will not happen easily.

Primary product dependency

Using the article above by Stiglitz, and the earlier information, complete the table below to summarise your analysis & evaluation of primary product dependency:

Analyse how primary product dependency might limit growth & development	 Evaluation: Benefits, solutions, success depends on…

Discussion questions

1. ‘Resource dependency is not the issue but the quality of institutions’. Expand on this statement

2. Adam Smith would recommend that countries should specialise in the production of goods they are best at producing. On the basis of this should developing countries concentrate on primary industry if they are resource rich and import manufactures?

Essay question:

To what extent is primary product dependency a constraint on economic growth and development in developing countries? (25)

PLAN your answer

6. Poor governance, corruption and absence of property rights

Governance: The process of making and implementing decisions

Good governance is characterised by:

- Democratic systems – likely to promote more economic growth (though not always e.g. China)
- Justice and the rule of law e.g. property rights
- Sound management of public finances
- Control of corruption

Poor governance is characterised by corruption:

- Money (including aid) may be embezzled by government employees rather than spent on public services or projects
- Resources may be allocated on the basis of bribes rather than on the basis of greatest net benefit
- Corruption may involve confiscation of property
- Government may spend money on weapons or other political instruments

Corruption: use of power for personal gain, e.g. bribery, extortion and diversion of resources to the governing elite.
Rent seeking culture: where the primary goal is to secure a job or position, which will give a good income without necessarily producing any goods or services.

Property rights: Legal confirmation of ownership, for example of land.
Absence of property rights: Individuals/businesses unable to use the law to defend their ownership of assets.

Absence of property rights

Country example: Zimbabwe
http://www.bbc.co.uk/news/world-africa-20649671
Take notes on poor governance/absence of property rights

Expropriation occurs when a local/national government takes private property for a purpose deemed to be in the public interest

Absence of property rights - a constraint on development

https://www.tutor2u.net/economics/blog/absence-a-property-rights-a-constraint-on-development

"Dead capital" is economist Hernando de Soto's term for an asset that cannot easily be bought, sold, valued or used an investment. De Soto's work argues that even those who live in slums possess far more capital than anyone realises. These possessions, however, are not represented in such a way as to make them effective financial assets because of an absence of property rights. Dead capital cannot therefore, create value for the poor.

Country example: Venezuela

Venezuelan National Assembly to Investigate Expropriated Land, Communes Threatened

By **LUCAS KOERNER**

Caracas, January 28, 2016. (venezuelanalysis.com)

After passing a motion by majority vote on Tuesday, Venezuela's National Assembly will launch an inquiry into the expropriations of privately owned land and enterprises spearheaded by the socialist government in past years. The country's newly elected parliament, dominated by the right-wing opposition, has vowed to reverse the socialist government's social and economic policies, which included the breakup of large private firms and landholdings deemed unproductive and their transfer to state, worker, or communal control. According to the legislative body's Finance Commission, the investigation will extend to expropriated plantations, enterprises, and agro-industries with aim of "comparing the levels of production before and after expropriation".

A key target of the parliamentary audit is the state agricultural enterprise Agropatria, which was created following the expropriation of the Spanish agricultural firm Agroisleña. As the main provider of credits to small farmers, Agropatria has nonetheless been criticized for its failure to promote large-scale agricultural production in the oil-rich country, which has imported the majority of its food items for decades. State expropriations have also turned over large tracks of privately-owned land to small farmers and communes under Venezuela's revolutionary land law, which permits the breakup of idle, outsized states and legalizes campesino land occupations.

A principal beneficiary of this policy has been the country's growing commune movement which fused direct democratic self-governance with enterprise geared towards local and regional consumption.

The communards took aim at the opposition governor of Lara state, Henri Falcon, who recently called for expropriated firms and plantations to be "returned" to their previous owners, while dismissing the new enterprises and communes as unproductive.

The Lara communes called for support from the national government, underlining the achievements of their five communal enterprises, including the construction of 205 houses and two schools, gas distribution to three municipalities, as well as the production of nearly 13 million kilos of corn and 400,000 kilos of meat, among other goods.

Published on Jan 28th 2016 at 9.41pm

Crystallex awarded $1.386 billion for Las Cristinas gold mine expropriation by Venezuela
Posted by John On April 14, 2016
http://im-mining.com/2016/04/14/crystallex-awarded-1-386-billion-for-las-cristinas-gold-mine-expropriation-by-venezuela/

Crystallex International has welcomed the award released by the Additional Facility of the World Bank's International Centre for Settlement of Investment Disputes (ICSID) in relation to its claims against the Bolivarian Republic of Venezuela ("Venezuela"). The tribunal awarded the company damages of $1.202 Billion plus pre- and post-award interest due to Venezuela's unfair and inequitable treatment, and unlawful expropriation of Crystallex's investment in the Las Cristinas mining project.
Crystallex filed its Request for Arbitration before ICSID's Additional Facility on February 16, 2011 pursuant to the Agreement between the Government of Canada and the Government of the Republic of Venezuela for the Promotion and Protection of Investments (the Treaty).
The Award, which was rendered on April 4, 2016, upheld Crystallex's claims that Venezuela breached Articles II(2) and VII(1) of the Treaty by failing to accord Crystallex's investments in Venezuela fair and equitable treatment and by unlawfully expropriating those investments.

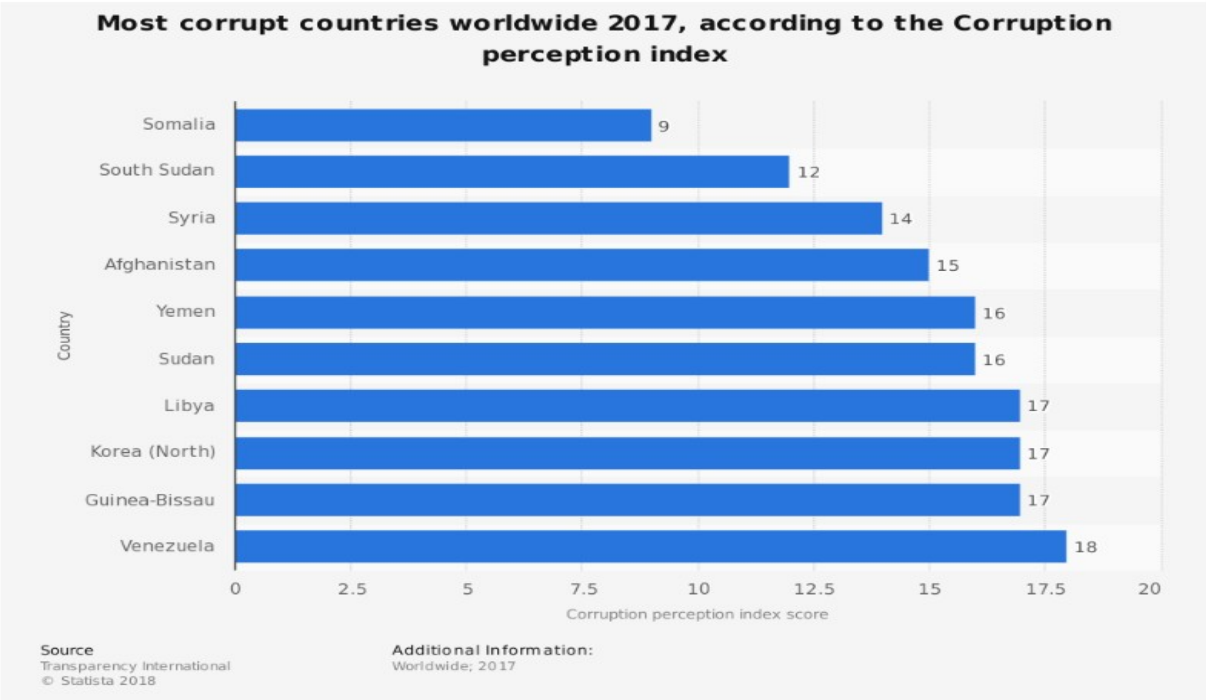
Absence of property rights:

Problems: limits to growth & development	 Evaluation: advantages, significance, solutions, depends on

Corruption Perception Index

Published by Transparency International, the Corruption Perceptions Index ranks 180 countries by their perceived levels of public sector corruption according to experts and business people, using a scale of 0 to 100, where 0 is highly corrupt and 100 is very clean. This year, the index found that more than two-thirds of countries score below 50, with an average score of 43 and highlights that the majority of countries are making little or no progress in ending corruption.

https://www.transparency.org/news/feature/corruption_perceptions_index_2017?gclid=EAIaIQobChMIw6a7o8We2wIVEpMbCh056wikEAAYASAAEgJTgvD_BwE



Poor governance/corruption: Analysis & evaluation

Problems: limits to growth & development	 Evaluation: significance, solutions, depends on

7. Access to credit and banking

In developed countries, individuals, firms and governments have access to sophisticated financial systems that allow them to save money with interest and to borrow money. The poorer the developing country, the less likely individuals and businesses will have access to such financial institutions. Strategies to deal with this include **microfinance (**you will study this later in theme 4). The use of mobile phones in banking has also helped in recent years.

Explain how lack of access to a sophisticated financial system could limit growth and development

8. Savings gap: Harrod-Domar Model

Savings gap: in development economics, the difference between the actual level of savings in an economy and the level of savings needed to finance the investment required for a higher rate of economic growth.

Harrod-Domar growth model: a model which suggests that economic growth is dependent on the savings ratio and technological progress.

Convincing Mozambicans to put money in the bank

By Jose Tembe, BBC News, Maputo, 15 August 2011

Like many Mozambicans, university graduate Fatima Nimbire does not trust banks and prefers to keep her money at home in a suitcase. "I think keeping it at home is also saving," the 28 year old says. Bernicia Cotela, also a resident of Mozambique's capital, Maputo, has a bank account, but it is not active. "I don't keep any money in the account because my salary is less than $200 (£120)," says Ms Cotela, who works as a radio announcer. "That's not enough for my expenses like health, electricity, education, housing, so I don't believe in saving money in the bank."

But a key reason Mozambique is one of the countries in the world where so few people have or use bank accounts is because there are so few banks. While bankers may not be popular elsewhere, Mozambique's government thinks it is lack of bankers and banking facilities is keeping people in poverty. President Armando Guebuza has now launched a nationwide campaign aimed at promoting savings and getting people to open bank accounts. According to the president, if more people in Mozambique saved some of their earnings, the country would be able to develop more quickly.

Like most of sub-Saharan Africa, the informal sector is massive in Mozambique, but the profits are rarely deposited. The government says if they were that cash could help banks provide loans to other businesses, which could in turn create jobs. "There is a lot of money in the people's hands, in their homes, some people bury their money in the ground," says Manuel Camilo Ntave, a journalist who covers economic issues. It is this money that the government is hoping to tap into. However, with a population of 23 million, only 10% have access to banking facilities.

It is not surprising that many are sceptical about the president's initiative. University student Luhamud Matsinhe argues that while the campaign is a good idea, it is unrealistic because most of the country's population live in rural areas where banking facilities are limited or non-existent. Currently, less than half of the country's 128 districts have banking services. Poor transport limits access to banks. He also says the majority of Mozambicans have low or no incomes. The governor of the Mozambican central bank, Ernesto Gove, says the primary aim of the campaign is to promote investment. "Without saving, there is no investment, so we have to save," he says. He projects that within five years 80% of the country should have access to banking facilities. But for the moment, the physical distance from banks - coupled with poor transport links - and the low saving rates, may mean saving methods, like Ms Nimbire's suitcase, will remain the norm. The Mozambican government will have to overcome such challenges if it is to achieve the primary goal of the campaign - to use people's savings to finance entrepreneurs and spur development from the grassroots.

Country example: Mozambique

Classwork: Answer questions on news report '**Convincing Mozambicans to put money in the bank'.**

1. Identify reasons why bank savings are low in Mozambique.

2. Why would higher savings be beneficial to economic development?

3. Evaluate the extent to which government plans to raise bank savings are achievable.

The savings gap in Africa

Africa is estimated to lose hundreds of billions of dollars in domestic revenues annually through capital flight, tax evasion, the repatriation of profits by transnational corporations and high debt repayments. At the same time, the continent's large informal sector holds considerable financial resources that are not deposited in savings accounts or pass through other formal financial channels.

Sub-Saharan Africa has the lowest savings rate in the developing world. While figures vary from country to country, gross domestic savings in the region averaged about 18 per cent of gross domestic product (GDP) in 2005, compared with 26 per cent in South Asia and nearly 43 per cent in East Asia and Pacific countries, according to World Bank estimates. In some countries, those rates are even on the decline. South Africa alone accounts for almost 40 per cent of sub-Saharan Africa's total GDP.

There are many reasons for Africa's low savings rates, including inadequate financial services. Physical distance from banking institutions and high minimum deposit and balance requirements mean that the majority of the population does not get access to banking services. As a result, only 20 per cent of African families have bank accounts.

Although a handful of countries have achieved higher savings rates, the bottom line is that the region's savings rate "is not commensurable with the investment needs of 25 per cent of GDP required to reduce poverty by 2015," argues Jean Thisen, a senior economic affairs officer with the UN Economic Commission for Africa (ECA).

Many Africans still keep most of their savings in livestock, stockpiles of goods for trading, grain, jewellery or construction material. Data are limited, but some experts estimate that about 80 per cent of all household assets in rural Africa are in non-financial forms. To tap into such assets, it is necessary to "introduce new financial products or instruments that respond to the saving needs of households," says Mr. Gayi of UNCTAD. Savings products that "permit easy accessibility" and allow for "small transactions at frequent intervals" would encourage households to shift to the formal system, thereby making such assets available for productive investments, he says.

1. To what extent are savings rates inadequate in African countries?

2. What type of asset do many people prefer to bank savings and why?

3. How could banks attract more household savings?

Evaluation: Use of mobile phone banking, Country example: Kenya

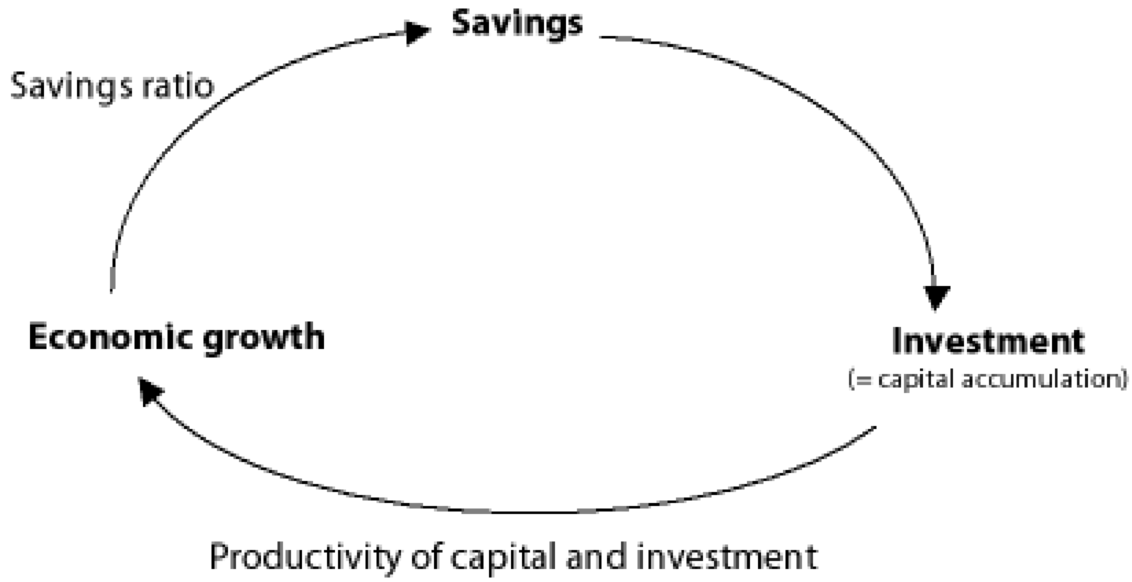
http://www.tutor2u.net/blog/index.php/economics/comments/unit-4-macro-mobile-technology-helps-kenyan-farmers

Watch the video clip and take notes on the benefits to Kenyan farmers of mobile phone banking

Harrod-Domar growth model (1930's)

Harrod-Domar model: An economic model which argues that an economy's growth rate is a function of the level of **saving** (and hence **investment**) and its **capital-output ratio.**

Capital accumulation: increasing the capital stock.
Capital-output ratio: the number of units of capital required to produce a unit of output over a given period of time. For example, a capital-output ratio of 3 would indicate that three units of capital are needed to produce each unit of output (e.g. annually).



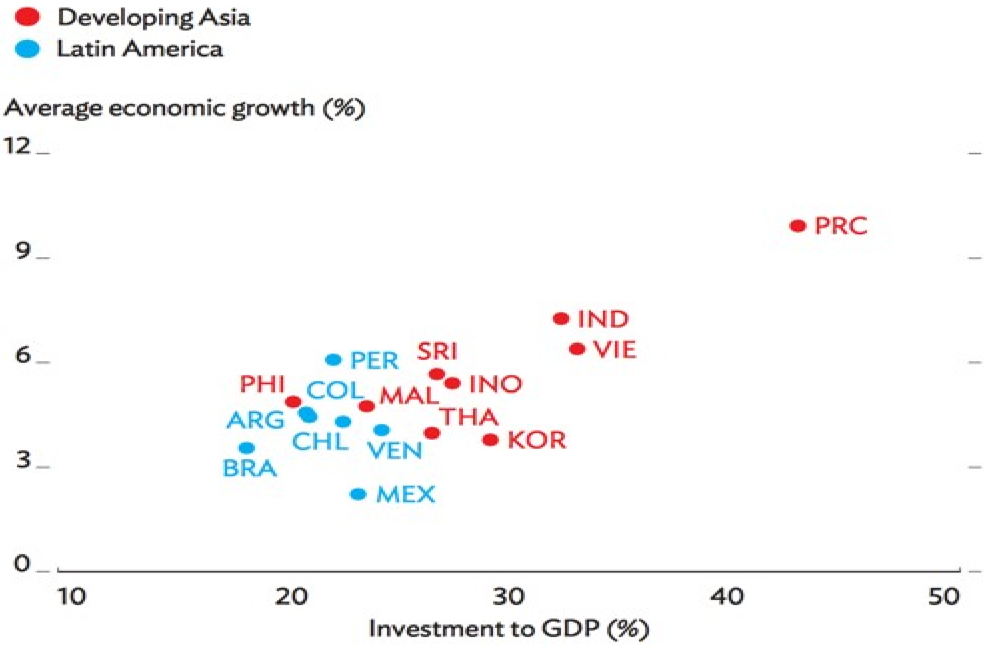
Key variables in determining growth are:

- **Investment:** increased investment pushes out PPF.
- **Savings:** required to fund investment.
- **Technological change**: New technology improves the productivity of capital, so pushing out PPF, and reducing the capital/output ratio. (e.g. if £5 worth of capital is needed to produce £1 of annual output, a capital output ratio of 5 to 1 would exist. A lower ratio is favourable for faster growth with given investment level).

Policy implications

- Higher savings desirable, possibly requiring external finance to fill "**savings gap**", e.g. **foreign aid,** or **borrowing from abroad**.
- Technological change desirable to raise capital-output ratio.

2.2.4 Investment and economic growth, 2000–2013



ARG = Argentina, BRA = Brazil, CHL = Chile, COL = Colombia, IND = India, INO = Indonesia, KOR = Republic of Korea, MAL = Malaysia, MEX = Mexico, PER = Peru, PHI = Philippines, PRC = People's Republic of China, SRI = Sri Lanka, THA = Thailand, VEN = Venezuela, VIE = Viet Nam.

Source: International Monetary Fund 2014.

time to evaluate

Evaluation: To what extent is there a correlation between investment and economic growth?

Savings gap & Harrod-Domar model:

Analyse why a savings gap limits growth/development according to Harrod-Domar	time to evaluate — Evaluation: significance, possible solutions, depends on.

9. Foreign currency gap

Foreign currency gap (foreign exchange gap): the difference between the actual level of exports and the level of exports needed to create higher economic growth for an economy.

The developing country faces a shortage of the foreign currency required to pay for imports needed for growth/development. They will be unable to buy imports unless they are able to borrow from abroad or sell assets to obtain the foreign currency needed to pay for imports.
Possible causes include:

- Export revenues fall
- Price of imported commodities rises
- Large international debts, and rising interest rates

Recently some PPD oil exporting countries have faced a foreign currency gap, as falling oil prices have cut their export revenues.

Country example: Venezuela
Read the following articles and answer the two questions:

1. How is the foreign currency gap limiting growth and development in Venezuela?

2. To what extent is Venezuela able to finance their foreign currency gap? What sources of finance are they using? Are these sources sustainable?

Coca-Cola stops production in Venezuela Extracts from: Sunday Telegraph, Sunday 22nd May 2015
Coca-Cola has announced that it is halting production in Venezuela, as the country cannot provide enough sugar for its local plants. The move comes as Venezuela's economy is on the edge of collapse with widespread food shortages, looting and riots, and inflation forecast to surpass 700 per cent. Imported Coca-Cola will still be available, but at a price likely to be unaffordable to ordinary Venezuelans. Meanwhile, queues for food and basic household items such as toilet paper last for hours and violence by mobs across the country grows. Local sugar suppliers in Venezuela informed Coca-Cola that they will temporarily cease operations due to a lack of raw materials.

Venezuela: when socialism goes wrong Extracts from: Sunday Telegraph, 22nd May 2015

The oil price collapse served as a wake-up call for a country that chose profligacy over prudence in the hope that a rainy day would never come. Oil accounts for 98% of total exports and 59% of fiscal revenues. Venezuela is now on the way to hyperinflation as the government prints money to try to plug a gap between revenues and spending that is on course to hit 25% of GDP next year.

The Venezuelan government is desperately trying to reduce its imports in order to close the massive black hole that has opened up in the country's finances. "We've had a 40% year-on-year contraction in the first three months this year, which takes the first quarter back to the same level of imports we had in 2004" says Alejandro Arreaza, an economist at Barclays. "If we keep on going at this pace, that would represent a contraction of almost £20 bn compared to Venezuela's imports last year. These are very aggressive cuts."

The social costs of such a move have been laid bare for all to see. Hospitals and pharmacies are desperately short of even basic medicines. "People in Venezuela now say they can't afford to get ill because when you turn up at the hospital there is nothing." says Moya-Ocampos, risk analyst at IHS. Rich or poor, the situation is critical. "I recently met with a governor of one of Venezuela's biggest states" says one source, "He's very popular and very well connected, but all of his staff needed three days to locate some medicine for his grandson. Three days."

Thousands turn to social media to barter goods. On Facebook, people offer to swap razors for cough syrup, toothpaste for sugar and oil for wet wipes. Demand for antibiotics is voracious. In one post, someone offers seven boxes of amoxicillin – a form of penicillin. Within minutes, he is inundated with requests.

One Venezuelan businessman describes "I fly between the US and Venezuela, during my last few trips I have had to go with a huge suitcase, as everyone wants me to bring something. Last time I even brought car parts for my brother because he couldn't find them anywhere".

There is also the question of whether Venezuela will be able to service its debts, with $116 bn due over the next two decades. Investors are sceptical and the market is pricing in a 95% chance of default over the next 5 years. Around a fifth of payments are due over the next two years, while PDVSA, Venezuela's state-owned oil and gas company, is due to repay $3.3 bn at the end of October and the start of November. If oil averages $44 a barrel this year, Barclays says Venezuela faces a financing gap of $20 bn in 2016, even accounting for the massive reduction in imports.

The bank is optimistic in the short term. "We believe they can part-finance this gap through $5 bn from China (renegotiating oil-for-loans deal), around $1.5 bn from other multilateral and bilateral loans, $2 bn from oil companies and other lenders and up to $1 bn from asset sales. The rest will have to be financed with gold that they have in international reserves and other assets. But reserves are dwindling fast, Venezuela's gold is now worth $11 bn, down from $ 21 bn in 2010. Arreaza says that in the long run a new regime could help the country back on its feet, with help from the IMF.

Country example: Nigeria

Nigeria's economy: Hope the naira falls

President Muhammadu Buhari is repeating an economic error he made as dictator 30 years ago, The Economist, Jan 30th 2016

Muhammadu Buhari, a former general, has not had much luck when it comes to the oil price. Between 1983 and 1985 he was Nigeria's military ruler. Just before he took over, oil prices began a lengthy collapse; the country's export earnings fell by more than half. The economy went into a deep recession and Mr Buhari, unable to cope, was overthrown in a coup.

Muhammadu Buhari has recently been elected president of Nigeria, at a time that oil prices have fallen to $32 a barrel. Growth probably fell by half in 2015, from 6.3% to little more than 3%. Oil accounts for 70% of the government's revenues and 95% of export earnings. The government deficit will widen this year to about 3.5% of GDP. The currency, the naira, is under pressure. The central bank insists on an exchange rate of 197-199 naira to the dollar. On the black market, dollars sell for 300 naira or more.

Instead of letting the naira depreciate to reflect the country's loss of purchasing power, Mr Buhari's government is trying to keep it aloft. The central bank has restricted the supply of dollars and banned the import of a long list of goods, from shovels and rice to toothpicks. It hopes that this will maintain reserves and stimulate domestic production.

When the currency is devalued, all imports become more expensive. But under Mr Buhari's system the restrictions on imports are by government fiat. Factory bosses complain they cannot import raw materials such as chemicals and fret that, if this continues, they may have to shut down. Many have turned to the black market to obtain dollars, and are doubtless smuggling in some of the goods that have been banned.

Nigerians have heard this tune before. Indeed, Mr Buhari tried something similar the last time he was president. Then, as now, he resisted what he called the "bitter pill" of devaluation. When, as a result, foreign currency ran short, he rationed it and slashed imports by more than half. When Nigerians turned to the black market he sealed the country's borders. When unemployment surged he expelled 700,000 migrants.

Barking orders at markets did not work then, and it will not work now. Mr Buhari is right that devaluation will lead to inflation—as it has in other commodity exporters. But Nigeria's policy of limiting imports and creating scarcity will be even more inflationary. A weaker currency would spur domestic production more than import bans can and, in the long run, hurt consumers less. The country needs foreign capital to finance its deficits but, under today's policies, it will struggle to get any. Foreign investors assume that any Nigerian asset they buy in naira now will cost less later, after the currency has devalued. So they wait.

He has indicated that he will stop subsidising fuel and selling it at below-market prices. This is brave, since the subsidies are popular, even though they have been a disaster (the cheap fuel was often sold abroad and petrol stations frequently ran dry).

1. How important are oil revenues to the Nigerian economy?

2. Explain why a fall in oil prices would create a foreign currency gap in Nigeria.

3. What measures has the president taken to deal with the foreign currency gap?

4. Would he be better advised to let the official exchange rate fall?

Foreign currency gap as a limit to growth & development:

Problems	 Evaluation: Significance/ extent of problem/ solutions/ depends on

10. Capital flight

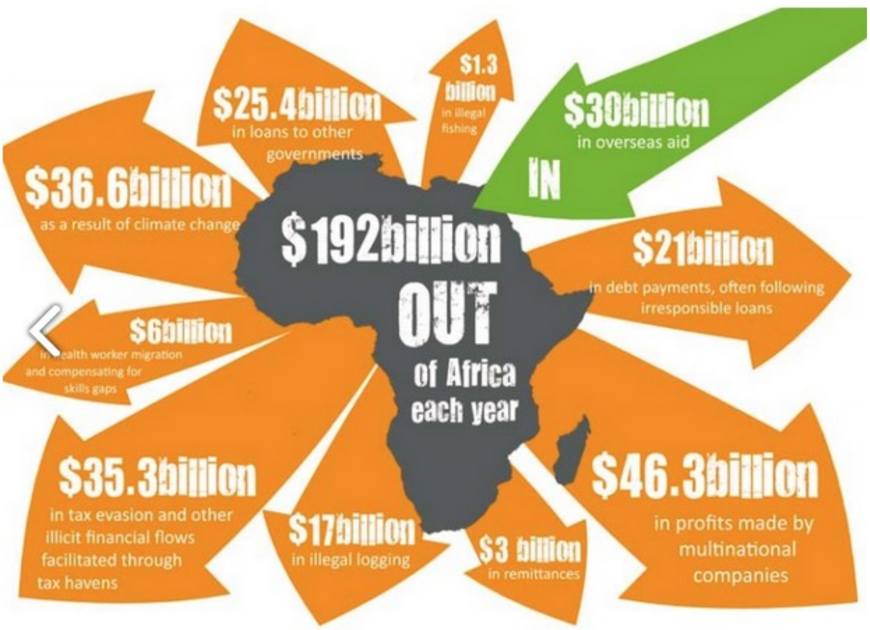
Capital flight: When savings are sent abroad by citizens and firms of a country to another country which is either seen as being more secure or where the money can be hidden from government authorities. **Capital controls**: restrictions on residents acquiring foreign assets (capital outflow) and/or restrictions on foreigners acquiring assets in the country (capital inflows). **Currency/exchange controls:** limits on the amount of foreign currency that can be bought e.g. currency can only be bought & sold through the central bank.

Capital flight occurs when citizens/businesses send their money abroad by buying foreign currency and other foreign assets.

- Because they believe economy will deteriorate, domestic currency will fall in value, or may fear assets will be seized if weak rule of law or corrupt government.
- Corrupt officials/politicians may send savings abroad e.g. buying property in London
- This reduces finance for domestic development and limits tax base as country loses any tax payable on these assets.

Capital flight: how does it impact development?

Capital flight entails the movement of assets or money out of a country or region. It can be a completely legal process, as when foreign investors decide to withdraw capital from a country as a result of an event of political or economic significance; or illegal, in the form of **illicit financial flows** (IFFS). The increase of illicit financial flows is a pressing issue for many developing countries. The sheer scale of the problem is striking when estimates of capital flight are put side by side with the amount of foreign aid flowing into Africa, and the countries' debts. Capital flight is estimated to be 10 times the annual foreign aid flow and twice the amount of the debt being repaid by the emerging countries every year. Corrupt heads of state illicitly move state funds, very often received from developed countries, international development organisations or NGOs, into their private accounts to enrich themselves.



Capital flight has a strongly **negative effect on the economy**, as corruption and embezzlement of public resources **reduce government revenue.** The government's capacity to finance social services and other public investments is greatly eroded due to such drains on the resources. Moreover, the tax burden is being shifted on the middle class and the poor who effectively have to subsidize social services due to **tax evasion- a form of capital flight - by high-earning organisations.**

Consider the case of **Equatorial Guinea** which has sufficiently large domestic resources to manage poverty reduction. Since the discovery of its vast off-shore oil resources in 1995, the state revenue has sky-rocketed, and the country currently tops the list of African countries in terms of GDP per capita.

Despite having a population of less than 1 million people, the living conditions have not dramatically improved, as one might have hoped. The Obiang government has moderately increased spending on health care and other social services, yet the infant mortality rate remains among the highest in the world, while the living expectancy is only 52.6 years. The **alleged appropriation of part of oil revenues** by the ruling elite in Equatorial Guinea plays an important role in the failure to use resources to improve the lives of people in the country.

The **largest oil exporters** in Africa, such as Nigeria, Angola, Gabon or Congo, feature on the **top of the list in terms of volume of capital flight**, implying a potential **correlation between the incidence of capital flight and high resource endowment.** However, a **poor record of governance** is a strongly contributing factor and should be considered in conjunction with natural resource wealth. Poor governance is inextricably linked with **endemic corruption, lack of transparency and ineffectiveness of the legal system**, facilitating capital flight; most of the aforementioned countries were among the countries with highest level of corruption, according to Corruption Perceptions Index 2013.

Some of the issues involved in capital flight:

- There may be a bandwagon effect (as in Greece) where a small number of people withdraw their funds to transfer them abroad and others follow (in a crisis situation)
- Capital flight tends to only involve certain people in a country- the rich, corrupt public officials and large corporations- poor people are not involved
- Capital flight can reverse the benefits of foreign aid
- Taxes may not be collected meaning governments do not have the funds to spend on development (education, health care etc)
- MNCs use transfer pricing to avoid paying tax
- Weak governments contribute to tax evasion and other forms of capital flight
- Illicit money flows end up in European and Swiss bank accounts through complex banking systems

Make notes on the following issues:

The extent of capital flight from Africa

The meaning of illicit financial flows (IFFs)

The role and meaning of transfer pricing and foreign multinationals

The link to natural resource wealth

The role of corrupt government officials

The significance of tax evasion

The weakness of governments

Illegal trade e.g. drugs

Add further notes from the video clip on The Great Money Migration:

http://www.aljazeera.com/indepth/features/2014/04/africa-hobbled-capital-flight-20144296537621865.html

Capital flight as a limit to growth & development:

Problems	 Evaluation: Significance/ extent of problem/ solutions/ depends on

11. Debt
Many governments of LEDCs in 1970s and 1980s borrowed heavily and the burden of interest and repayment grew to be a significant % of GDP.

In the 1970's/early 1980's the governments of many developing countries borrowed money which they were later unable to repay or service the interest on the loans.

Default is the failure to promptly pay interest or principal when due. Default occurs when a debtor is unable to meet the legal obligation of debt repayment. Borrowers may default when they are unable to make the required payment or are unwilling to honour the debt.

How exactly do countries borrow?

Aside from traditional loans from, say, the IMF, usually this is done via…..
BONDS

- A bond (or 'stock') is just a loan or an IOU – a piece of paper:
  - offered for sale by a company (corporate bonds or debentures) or a government (gilts or Treasury Bills)
  - detailing:
    - the amount borrowed
    - the <u>fixed</u> interest sum ('coupon') to be paid annually
    - the maturity date (i.e. when the lender/buyer will get their money back) or term
- Bonds are traded on the financial markets, bought by either public sector institutions (e.g. foreign governments) or private sector institutions (e.g. banks).
- Prices go up and down according to the forces of demand & supply
  - driven predominantly by interest rates and speculation

Debt – good or bad?

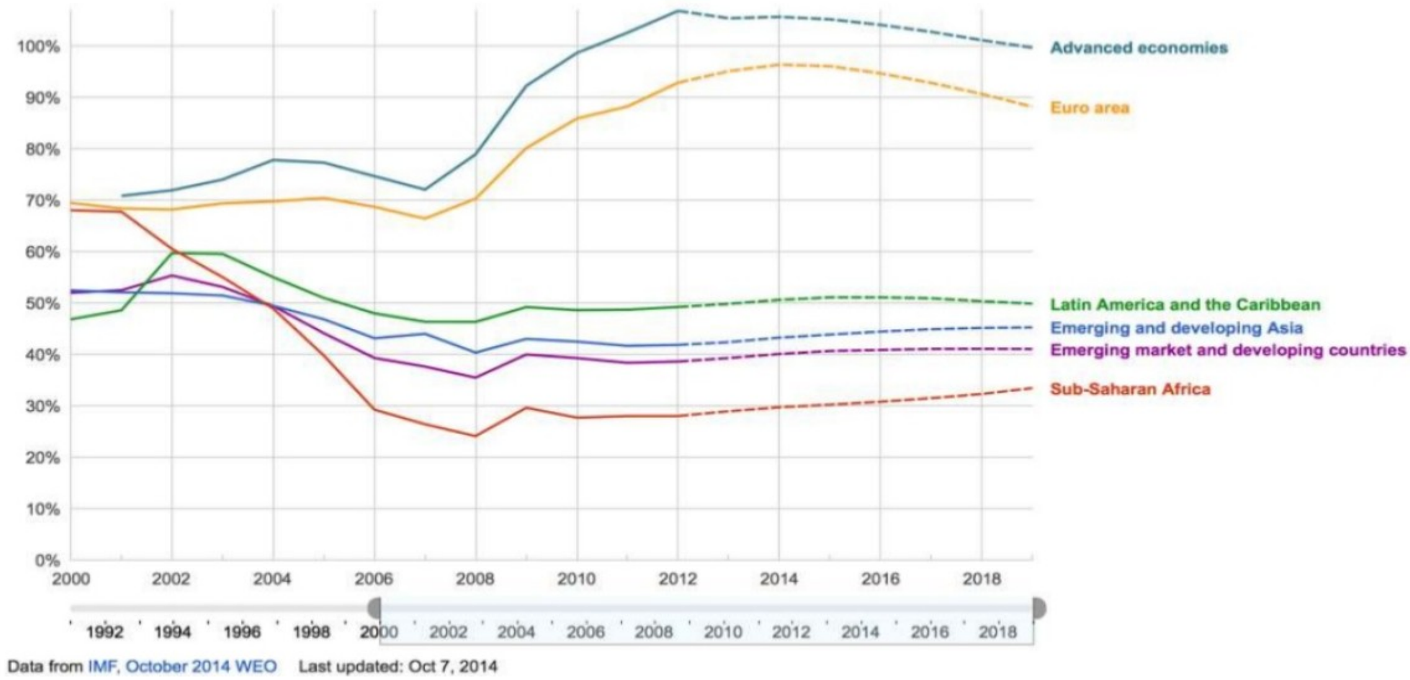
Debt is essential for investment and economic growth – the so-called Golden Rule of fiscal policy states that over the economic cycle, a Government should borrow only to invest and not to fund current spending – but it is when this becomes unsustainable that problems can occur.

How much debt is "too much"?

There are two key measures of the sustainability of national debt:
(1) the Debt:GDP ratio; and
(2) the ratio of debt servicing costs to exports

(1) the Debt:GDP ratio

Debt to GDP ratios for regions: General government gross debt (% of GDP)



Comment on changes in debt to GDP ratios for the regions shown:
To what extent does debt remain a constraint on growth & development across the world?

(2) the ratio of debt servicing costs to exports

This ratio is considered a key measure of ability of country to manage its debt successfully, as export revenues are needed to obtain the foreign currency to pay back debts.

Totals — Debt | service | Select year

#	COUNTRY	AMOUNT	DATE	GRAPH
1	Sierra Leone	102.05	2001	
2	Brazil	75.44	2001	
3	Argentina	66.3	2001	
4	Lebanon	50.87	2001	
5	Madagascar	43.27	2001	
6	Guinea-Bissau	41.06	2001	
7	Turkey	39.99	2001	
8	Burundi	39.81	2001	
9	Hungary	37.17	2001	
10	Uruguay	36.29	2001	
11	Colombia	36.13	2001	
12	Turkmenistan	31.79	1998	
13	Kazakhstan	31.37	2001	
14	Bolivia	31.12	2001	
15	Lithuania	30.95	2001	
16	Kyrgyzstan	29.82	2001	
17	Chile	28.13	2001	
18	Poland	27.97	2001	
19	Croatia	27.93	2001	
20	Mexico	26.47	2001	

http://www.nationmaster.com/country-info/stats/Economy/Debt-service (2001)

A 'debt crisis' may arise where the country is unable to pay interest and loan repayments, leading to a default. Possible reasons:

- Increase in interest rates
- Exchange rate fall increasing real value of debt/interest on USA $ loan
- Foreign currency gap due to oil price change/terms of trade deterioration.
- Natural disaster

Many LDCs hit ‘debt crisis’ in 1980s & 1990s, unable to afford interest as interest rates rising & value of USA $ rising (loans agreed in USA $). Mexico defaulted on loans & others followed.

World's poorest countries rocked by commodity slump and strong dollar Guardian, 10/4/16
Jubilee Debt Campaign warns that developing countries are struggling to make debt payments as revenues deteriorate. The collapse in global commodity prices and a stronger US dollar have depleted the public coffers of some of the world’s poorest countries and will leave them as much as $61bn (£43bn) worse off this year, a report has warned. The Jubilee Debt Campaign said that countries that relied on exports of commodities such as metals and oil had seen government revenues hit by a global markets rout last year that knocked the prices of crude oil, iron ore, copper and other raw materials to multi-year lows. At the same time, a drop in their currencies against the US dollar were making it harder for governments in poor countries to make debt payments in dollars, the anti-poverty campaigners said.

“Many impoverished country governments are being hit by the fall in prices for the commodities they export, and large depreciations of currencies against the dollar,” said Tim Jones, economist at the Jubilee Debt Campaign.

“This is reducing government revenue, and increasing the relative size of debt payments in foreign currencies. On top of this, less tax is being collected than had been expected.” The analysis of low and lower middle income country governments showed their external debt service payments in 2016 will on average be 10.8% of government revenue, compared with 6.1% predicted three years ago. “In the 1980s commodity prices crashed and the US dollar rose, and the result was 20 years of debt crisis and large increases in poverty. To ensure history is not repeated, urgent global action is needed to cancel debts owed to reckless lenders, tackle tax avoidance and evasion, and change global trade rules to enable countries to diversify out of basic commodities,” said Jones.

Jones highlighted the case of Sierra Leone’s economy, hit both by the Ebola crisis and the collapse in the price of iron ore. Government revenue in 2016 is now expected to be $470m, compared with a prediction of $760m three years ago. However, debt payments in 2016 will be lower than previously predicted, primarily because of a suspension of debt payments to the IMF in response to the Ebola outbreak.

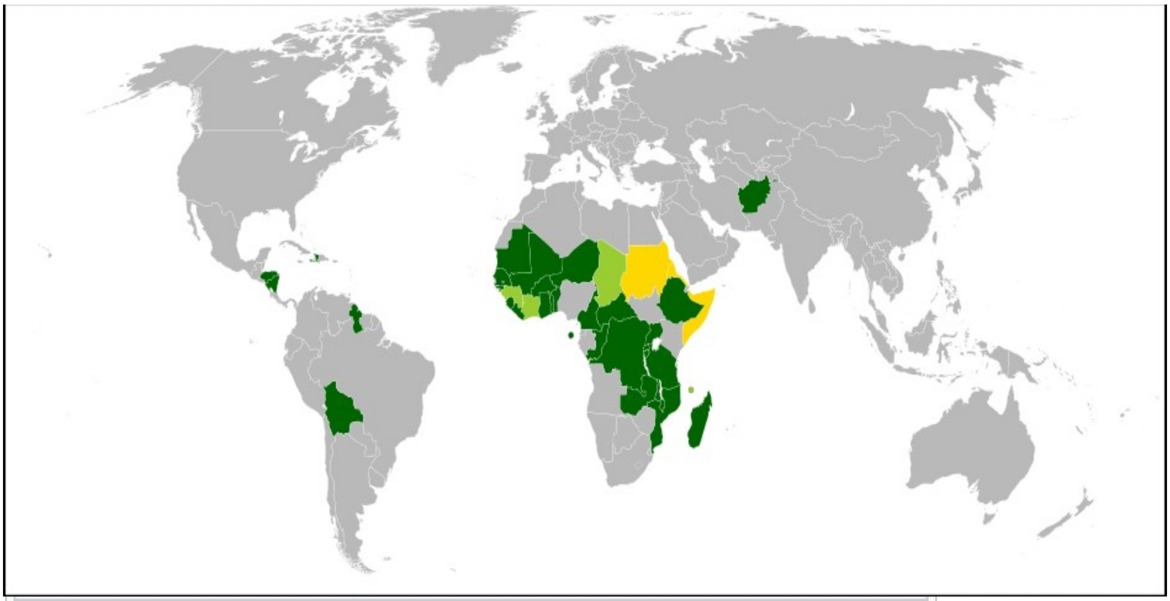
Explain why many countries are struggling to make debt repayments

Alleviating the burden of debt:

IMF set up **Structural Adjustment Programmes**, where it would lend debtors money to pay off original debts, but on strict conditions with respect to fiscal & trade policy.

The Heavily Indebted Poor Countries Initiative (HIPC)
- Started in 1996
- Joint initiative of IMF and World Bank
- Assistance as interim relief for most heavily indebted countries
- For countries with unsustainable debt

Criteria for countries to be eligible:
- Face unsustainable debt problems that cannot be addressed by traditional methods
- Have developed policies of reform and introduction of sound macroeconomic policies
- When criteria met the country is given full debt relief (from IMF, other international institutions and Paris Club members)



The states recognized as the Heavily Indebted Poor Countries (HIPC).

Countries qualifying for full HIPC relief.

Countries qualifying for partial HIPC relief.

Countries eligible for HIPC relief but not yet meeting the necessary conditions.

Multi-Lateral Debt Relief Initiative (MDRI) (2005): provided a group of low-income countries with 100 percent relief on eligible debt owed to the World Bank/IMF The initiative aimed to help eligible countries advance toward the United Nations' Millennium Development Goals (MDGs) focused on halving poverty by 2015.

The Paris Club

The Paris Club is a voluntary, informal group of creditor nations who meet approximately 10 times per year, to provide debt relief to developing countries. Members of the Paris Club agree to renegotiate and/or reduce official debt owed to them on a case-by-case basis. Members are Western European countries, UK, USA and Scandinavia.

Debt relief: The debt is written off/forgiven

Debt rescheduling, where the repayment terms are altered e.g. country given longer to repay

Debt & debt relief: Country examples: Guyana & Uganda
http://www.tutor2u.net/economics/blog/does-debt-relief-help-economies-grow

Guyana
What problems did debt create for Guyana?

What are the benefits of debt relief for Guyana?

Uganda
What are the benefits of debt relief for Uganda?

Issues with debt relief:

Putting aside any *moral* obligation to help HIPCs manage their debt, debt write-offs can result in….

MORAL HAZARD
If HIPCs conclude that if and when future debts become unmanageable, their creditors will just write them off, then it may encourage excessive borrowing and avoid addressing any underlying structural problems.

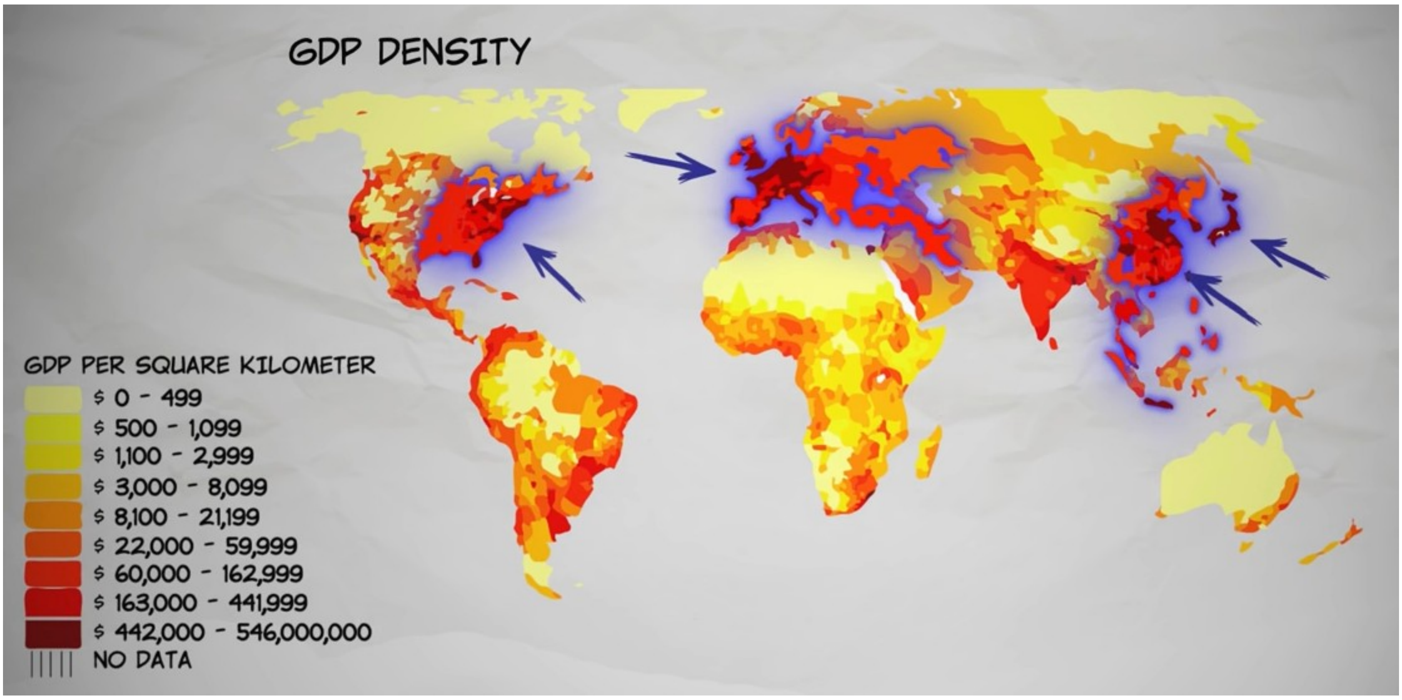
Does debt relief guarantee future success?

Class work: Analyse & evaluate debt as a limit to growth & development:

Problems: limits to growth & development	 **Evaluation: significance, solutions, depends on**

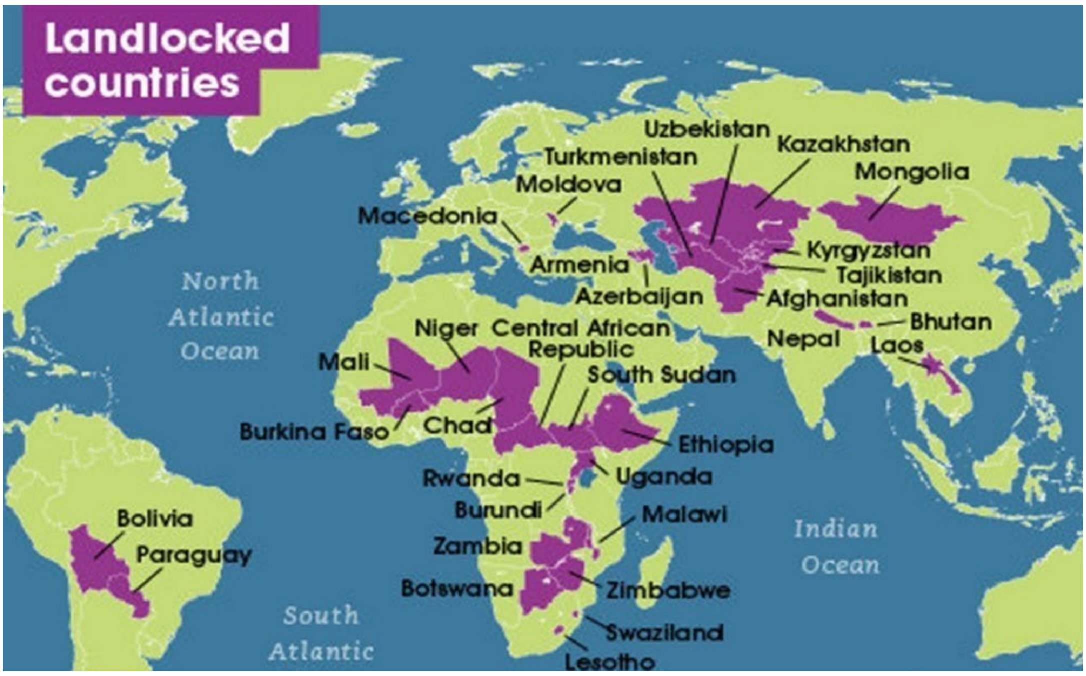
The impact of non-economic factors in different countries

Geography: access to the sea and waterways



Reason why GDP density is highest close to the sea and navigable waterways
https://www.youtube.com/watch?v=B8z6XS2jieE&nohtml5

Geography: Landlocked countries



Why do landlocked countries struggle to grow?

BOLIVIA'S quest to recover the coastline it lost in a 19th-century war looks like romantic folly. Much of its trade passes through Chile, and no political deal can reduce the distance between Bolivia's cities and the sea. But the loss is not just symbolic. If trade flowed freely, being landlocked would be no impediment to growth. In the real world, it is. With a few exceptions the world's 45 landlocked countries are poor. Of the 15 lowest-ranking countries in the Human Development Index, eight have no coastline. All of these are in Africa, which is a poor region. But even compared with similar sea-front countries those without coastlines have lagged behind. Their GDP per person is 40% lower than that of their maritime neighbours.

Their most obvious handicap is in moving goods to and from ports. International treaties promise access to the oceans, but responsibility for implementing them lies with the governments of the "transit states". They have little incentive to build infrastructure that would mainly help their neighbours. Border officials in both landlocked and transit countries often extract bribes and cause delays. According to Jean-François Arvis of the World Bank, lorries travelling to poor landlocked countries cover 250km (150 miles) a day. That is half the rate of progress of those driving just within neighbouring coastal states.

Enterprises regard landlocked trading partners as unreliable, since transit states can interrupt commerce. A strike by Chilean customs officials in 2013 caused a queue of lorries 20km (12 miles) long in Bolivia. This type of risk is especially grave in Africa, where civil strife is more common and landlocked countries often have to reroute trade at exorbitant cost. Businesses in those countries hold larger inventories to hedge against such disruptions, reducing their competitiveness.

The success of the few rich landlocked countries offers little hope to poorer ones. Switzerland specialises in finance, which does not travel by boat, and its high-end manufacturing is integrated with Europe's single market. Many of the goods it exports, such as watches, are expensive and small. Botswana, a middle-income landlocked country, exports diamonds, which are shipped by air. Unfortunately, countries like Bolivia cannot move next to Germany or discover diamonds. Even if Chile yielded to its demand for access to the sea, Bolivia might recover just five percentage points of its “missing” GDP, Mr Carmignani reckons. Its best hope lies in becoming part of an EU-style single market. That could take another century.

Edited from: http://www.economist.com/news/americas/21650574-why-its-better-have-coastline-interiors

Read the text above to complete the table:

Analyse how being a land locked country limits growth & development for Bolivia	 Evaluation: Extent of the problem, possible solution, depends on…

Political instability / war

Recent history of war in Afganistan
1979 - Soviet Army invades and props up communist government. More than a million people die in the ensuing war.

1989 - Last Soviet troops leave. US- and Pakistan-backed mujahideen push to overthrow Soviet-installed Afghan ruler Najibullah triggers devastating civil war.

1996 - Taliban seize control of Kabul and impose hard-line version of Islam.

2001 - US intervenes militarily following September 11 attacks on the United States. Taliban are ousted from Kabul and Hamid Karzai becomes head of an interim power-sharing government.

2002 - Nato assumes responsibility for maintaining security in Afghanistan.

2004 - Loya Jirga adopts new constitution which provides for strong presidency. Hamid Karzai is elected president.

2014 - Ashraf Ghani elected president. NATO formally ends its combat mission in Afghanistan, handing over to Afghan forces, who face a growing insurgency.

Source: http://www.bbc.co.uk/news/world-south-asia-12011352, BBC 11 Feb 2016

http://www.bbc.co.uk/news/world-asia-36424018

Watch the BBC clip: Why is the mining of Lapis not promoting development?

Afghanistan death toll rises fourfold to 15,000 since departure of US and British combat troops telegraph, Telegraph, 5 May 2016

The death toll in Afghanistan's civil war has quadrupled since American and British combat troops left the country, with 15,000 people being killed last year. Britain and the US withdrew most of their combat units from Afghanistan in 2013, handing over responsibility for security in almost all of the country to the new army and police force. In that year, the Taliban insurgency claimed 3,500 lives. The Taliban enjoyed a resurgence across Afghanistan, managing to hold more territory than at any time since they were driven from power in 2001. Power in Kabul is divided between Ashraf Ghani, the president, and his defeated rival in the last election, Abdullah Abdullah, who now serves as "chief executive". This divided government struggles to stay in office, let alone resist the Taliban or extend its authority across the country. The Afghan National Army has 150,000 soldiers while paramilitary units deploy another 150,000 troops.

Between 1,000 and 3,000 Isil fighters are now believed to be in Afghanistan, where they control an area of Nangarhar province near the frontier with Pakistan. Afghan forces rely heavily on US air support, particularly for the struggle against Isil. So far this year, between 60 and 80 American air strikes have targeted Isil in Afghanistan, including those by drones and strike aircraft.

Dozens killed and 300 injured as Kabul hit by Taliban suicide attack, Guardian 19th April 2016

http://www.theguardian.com/world/2016/apr/19/explosion-rocks-afghan-capital-kabul

Dozens were killed and more than 300 injured on Tuesday in a Taliban suicide attack on the headquarters of an elite military unit in central Kabul, one of the group's bloodiest ever attacks in the Afghan capital. The violence began just before 9am local time, when a truck packed with hundreds of kilograms of explosives was rammed into the compound of a security force that protects Afghan VIPs and government officials. Outside there was carnage on streets that had been crowded with people waiting at a nearby bus stop, or on their way to work or school. There was so much explosive used that it was felt on the other side of the city and shattered windows up to a kilometre away, and caused large numbers of injuries.

UN says 2015 was worst on record for civilian casualties in Afghanistan, Telegraph, 14 Feb 2016

In 2015, the UN recorded 3,545 civilian deaths and 7,457 injured. Women and children were often affected, making up 50 per cent of victims overall. "Unprecedented numbers of children were needlessly killed and injured last year – one in four casualties in 2015 was a child," said Danielle Bell, of the United Nations Assistance Mission in Afghanistan. "Other children suffered the loss of parents, and increasingly their mothers, sisters, and female role models – one in 10 casualties was a woman."

Since 2009, the UN has recorded 58,736 civilian casualties in the country. The UN also warned of a disturbing rise in targeted killings, with 850 deaths recorded. The vast majority of the murders were carried out by the Taliban, targeting aid workers, tribal elders, mullahs and civilian government officials.

UN reports stark rise in number of Afghan civilian casualties in 2015, Guardian 14th Feb 2016

Another troubling trend is the large number of targeted attacks, especially against judicial institutions and personnel. In one of the worst such attacks, the Taliban killed 14 people and wounded 47 when storming a prosecutor's office in Mazar-i Sharif in April. Foreign military personnel were responsible for 2% of civilian casualties. Almost half of the 170 casualties caused by international aerial operations occurred in a single incident – the US airstrike on a Médecins Sans Frontières hospital in Kunduz on 3 October, which killed at least 42 and wounded 43. A US military inquiry concluded the attack happened "in error", because the plane mistook the hospital for a government building occupied by Taliban.

Afghan boy who was declared a hero for fighting the Taliban gunned down on his way to school, Telegraph 3 Feb 2016

A 10-year-old Afghan boy who was declared a hero after fighting the Taliban has been shot dead by insurgents while on his way to school.

The use of child soldiers is illegal in Afghanistan, but both government forces and insurgents have been recruiting minors for years. In a June 2015 report presented to the U.N. Security Council's working group on children and armed conflict, the charity Child Soldiers International said children were recruited by the Afghan National Police and the Afghan Local Police. It said the recruitment was mainly driven by poverty, but also filial duty, patriotism and honor. The report said that in May of last year the charity found that half of national police checkpoints in Tirin Kot "were staffed with visibly younger officers," who all acknowledged they were under 18 years old. "They had been performing all the responsibilities of a police officer, which included securing checkpoints and engaging in combat for the last few years," the report said. Children are also used by the Taliban in active combat, as spies and as suicide bombers, the report said.

Afghan army moves into Helmand schools rebuilt with UK aid

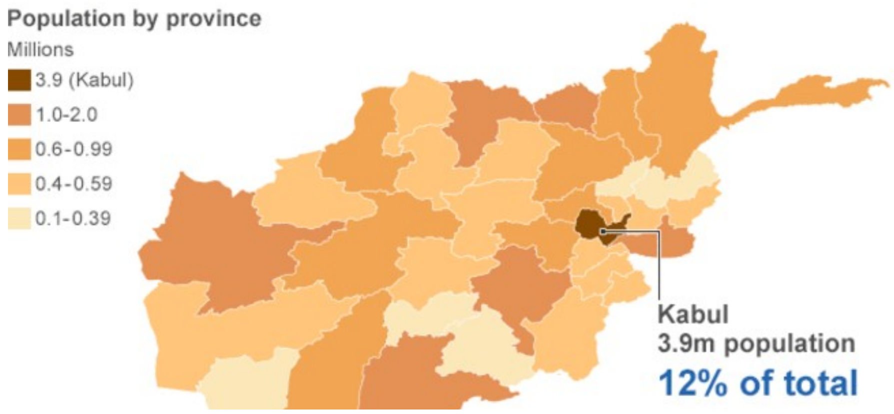
Source: http://www.theguardian.com/global-development/2016/apr/16/afghan-army-moves-into-helmand-schools-rebuilt-with-uk-aid, Guardian 16th april 2016

Two schools in Helmand that were refurbished using British aid money are now being used as bases for the Afghan army, the Guardian has learned. Pupils still attend one of the schools, in Sayedabad, Nad Ali district, which received about £100,000 from the British Provincial Reconstruction Team (PRT). Soldiers have built a rudimentary watchtower on the roof and walk heavily armed through the schoolyard. The other school, in Chahe Anjir, also in Nad Ali, was renovated by the British government for £450,000. It was abandoned six months ago and turned into an outpost for the army.

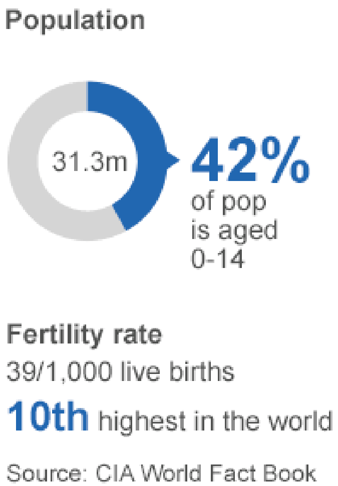
In 2015, the UN documented military use of 35 schools, compared with 12 the year before, said Danielle Bell, human rights director with the UN in Afghanistan, which will release a report on schools and medical facilities at risk next week. In 2015, 139,000 students were affected by school closures due to conflict, Bell said. The actual numbers are almost certainly higher due to the UN's lack of access to volatile areas. For instance, the two Helmand schools discovered by the Guardian do not figure in the UN report.

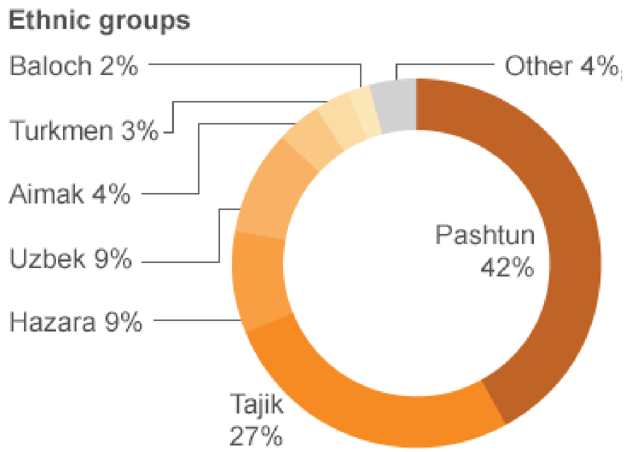
Afghanistan: Before and after the Taliban **Source:** http://www.bbc.co.uk/news/world-asia-26747712, 2 April 2014 BBC

Billions of dollars of foreign aid have been spent trying to secure a peaceful future for the country's inhabitants.



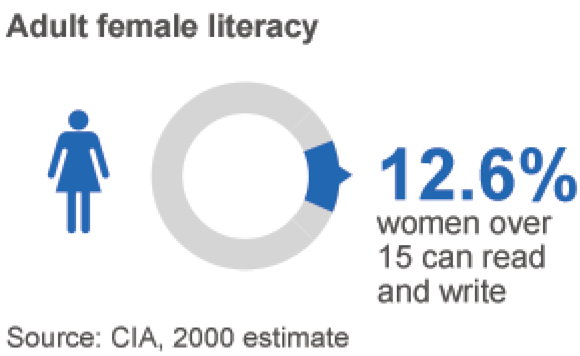
Afghanistan has a population of 31.3m and it is growing fast. Afghan women get married young and typically have five children on average. According to the CIA World Factbook, the country has the 10th highest birth rate in the world. According to the UN, 76% of Afghans still live in rural areas.





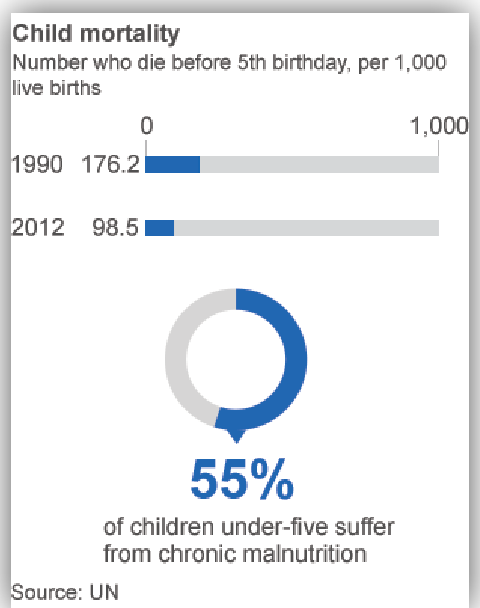
Education

The education system in Afghanistan is regarded as one of the country's biggest success stories since the Taliban were driven from power. In 2001 no girls attended formal schools and there were only one million boys enrolled. By 2012 the World Bank says there were 7.8 million pupils attending school - including about 2.9 million girls. However, many schools are still operating from tents, houses and under trees. The World Bank says of 180,000 teachers, only 52% meet the minimum standards required and the rest are receiving in-service training. Girls' dropout rates are still very high in secondary schools and the country's adult literacy rate, 39% over the age of 15 can read and write, is one of the lowest in the world.



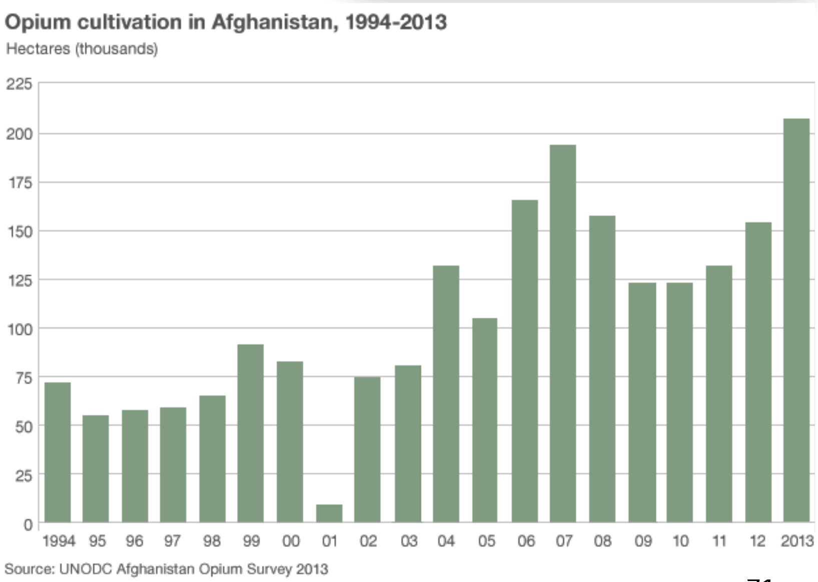
Women: The position of women in Afghanistan has begun to improve. Under the Taliban they were barred from attending school and going out to work. Latest figures from the World Bank say 36% of girls are now enrolled in school - although many do not complete their secondary education and figures from 2007 suggest 52% of women were married by the age of 20. Unicef reported a literacy rate of 22.2% among women aged 15-24 in 2010/11. Despite the advances, violence against women is still a problem, with beatings, forced marriage and lack of economic support being listed as the top three offences reported by the CSO in 2010.

The United Nations and its humanitarian partners are seeking US$406 million to provide five million people with essential, life-saving aid in 2014. Afghanistan has one of the world's largest repatriated populations. Almost six million refugees have now returned home since the Taliban were ousted - and the UNHCR estimates just under two million of these still require support. About 600,000 people are still recognised as internally displaced - most of them in the south and west of the country.



In 2010 Afghanistan had the lowest gross national income per head of population among the developing countries in Asia. According to the CIA World Factbook, 78.6% of Afghanistan's population is employed in agriculture. In 2008 the unemployment rate was estimated to be 35%. The number of people with access to the internet is now 5.5% - although many more people have access to mobile phones. The CIA World Factbook estimated there were 18 million mobile phones in circulation in the country in 2012.

Health: Life expectancy has increased slightly from 56 to 60 years. But there have been big improvements in the under-five mortality rate and the maternal mortality rates. According to the UN, access to safe drinking water improved from 4.8% of the population to 60.6% by 2011. Access to better sanitation, including private rather than shared toilets, has also improved to an average 37%. Vaccination campaigns continue to work towards the elimination of polio in Afghanistan.



Economy: Afghanistan's biggest export is still opium - despite attempts to persuade farmers to diversify. 2013 was a record year and the country produces 90% of the world's opium. Other exports include fruit and nuts, handwoven carpets and wool. Afghanistan is said to have rich mineral reserves, including natural gas, which have not been exploited due to the political situation in the country. It has one of the lowest rates of energy usage in the world. According to the World Bank only 28% of its population is connected to the national power grid and the service is unreliable.

Read the text / data and complete the table:

Explain how war / civil war limits growth & development	 Extent of problem, possible solutions, depends on…