Strategies to promote economic growth and economic development

Outline

This chapter will critically examine policies and strategies that developing countries may pursue in order to promote their growth and development.

1. International trade strategies
2. Diversification and social enterprise
3. Market-based policies
4. Interventionist policies: redistribution and provision of merit goods
5. Foreign direct investment and multinational corporations (MNCs)
6. Foreign aid
7. Multilateral development assistance
8. Institutional change

- Strengths and limitations of government intervention versus market-oriented approaches
- Progress toward meeting selected sustainable development Goals.

1. International trade strategies

1. International Trade Strategies

Four main types of trade strategies:

1.1 Import substitution
1.2 Export promotion
1.3 Economic integration
1.4 Trade liberalization

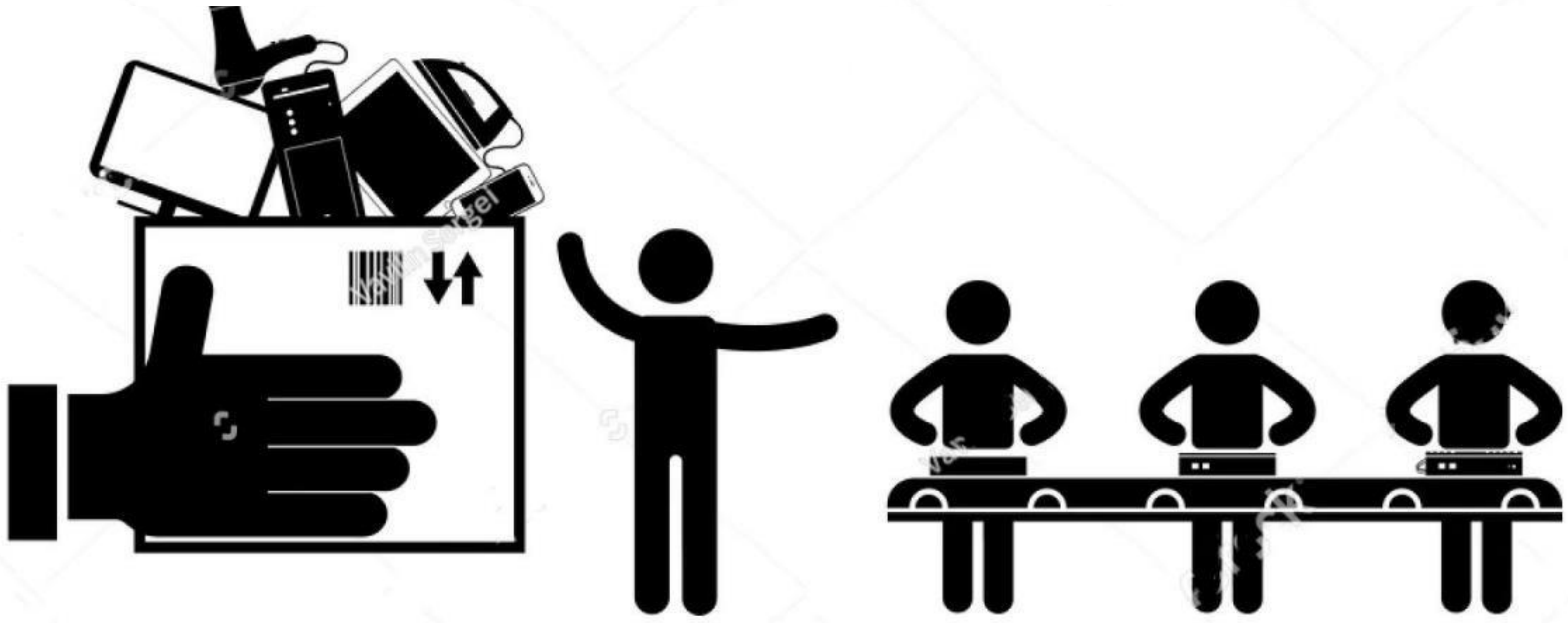
1.1 Import Substitution

Import substitution (import substituting industrialization)

→a growth and trade strategy where **a country begins to manufacture simple consumer goods for the domestic market** to promote its domestic industry.

- It depends on protective measures (tariffs, quotas, etc.) preventing the entry of imports that compete with domestic producers.
- Overvalued exchange rates to import capital inputs more cheaply.
- Many developing counties used it in the initial phases of their industrialization.

- It has been widely used by developing countries in 1930s-1960s. (Latin American countries)
- By the 1970s-1980s, economists agreed that it had not lived up to expectation. → switch to **export promotion**.
- Nowadays, there may be **selective import substitution** only.



Characteristics and consequences of Import Substitution (AO3)

a. High levels of protection of domestic firms, inefficiency and resource misallocation.

- Lack of competition
  - → high costs and inefficiency in private and public sector industries
  - → resource misallocation
  - → higher price for consumers.

b. Overvalued exchange rates.

- Countries overvalued their exchange rates → higher price for exports & lower price for imports → aim to allow firms to import capital inputs more cheaply.
  - →Cheap capital imports led to capital-intensive production methods(inappropriate technologies), unemployment and growth of the informal economy in urban areas.
  - →It made agricultural exports more expensive, worsening rural poverty.

Characteristics and consequences of Import Substitution (AO3)

c. Too much government intervention in the economy.

- Countries rely heavily on industrial policies (interventionist supply-side policies), using
  - Protective trade barriers
  - Overvalued exchange rates
  - Subsidized credit
  - Tax allowances
  - Production subsidies
  - Wage subsidies
  - Price controls
  - Extensive public ownership of firms and industries

→serious resource misallocation and inefficiencies in production

d. Neglect of agriculture

- Failure to make agricultural investments → increased need for food imports.

Characteristics and consequences of Import Substitution (AO3)

e. Deterioration in the balance of payments, due to:

- Increasing imports of capital equipment as inputs in production
- Increased need for food imports
- Outward flow of financial capital due to profit repatriation of foreign multinational corporations (profits taken to the home country)

f. Encouragement of capital-intensive production methods

- Too much emphasis on capital-intensive production.
- No efforts to provide support for small entrepreneurs more likely to use labor-intensive techniques.

Characteristics and consequences of Import Substitution (AO3)

g. Negative impacts on employment and income distribution

- Capital-intensive technologies and the neglect of small producers
  - →increased unemployment
  - →Development and growth of informal economy
  - →Worsening income distribution and increasing poverty

h. Limited possibilities for growth over the longer term

- Short-run: economic growth
- Long-run: there comes a point when it was no longer possible to grow through import substitution.
- Main Reason → serious inefficiencies (high costs of production)
  - Inefficient, high cost "protected" firms
  - Opportunity cost: those firms should have been set up or expanded were not get the support they needed.

1.2 Export promotion

Export Promotion is a growth and trade strategy where a country attempts to achieve economic growth by expanding exports.

✓ Strong government intervention –develop a strong manufacturing sector oriented towards exports.

- Export promotion strategies evolved gradually as an extension of import substitution.
  - The strong exporting firms/industries usually were the ones that had received strong import-substituting protection.

→Increased AD → good export performance & high growth rate

→Improvement in economic dev' and human dev'

- *Countries first turned to export promotion: China, Indonesia, Japan, Malaysia, Singapore, South Korea, Thailand and others.*

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1.2 Export promotion - Policies

1.2.1 Financial assistance to targeted key industries

- Targeting of export industries that used increasingly higher skill and technological levels.
- Industrial policies to support export industries
  - Investment grants
  - Production subsidies
  - Exemptions from tariffs of imported inputs
  - Tax exemption
  - Export subsidies
  - Special benefits for export oriented multinational corporations.
- Provision of incentives to the private sector for R&D in high technology products
  - Encourage the development of domestic skills and technologies appropriate to local conditions.

1.2 Export promotion - Policies

1.2.2 Strong government intervention in the economy, including:

- State ownership and control of financial institutions (banking and insurance) → provide subsidized credit to the industries being promoted
  - Lower interest rates
  - Other favorable borrowing terms
- Large public investment in key areas, including
  - Education and skills
  - R&D
  - Expansion and modernization of transport and communications infrastructure.

1.2.3 Requirements imposed on multinational corporations

- Promotion of R&D
- Transfer of desired and targeted technologies into the domestic economy
- Training of domestic workers
- Use of local inputs

1.2.4 Exchange rate management – undervalued currencies → encourage exports, discourage imports

1.2 Export promotion – Advantages over import substitution (AO3)

a. Expansion into foreign markets
- Economies of scale

b. Emphasis on diversification
- At the beginning – support simple, labor-intensive goods (textiles, clothing, etc.)
- Later on – support diversification based on increasing skill and technology levels

c. Major investment in human capital (education, training and skills)

d. Appropriate technologies
- Government support R&D for the development of appropriate technologies
- Transfer from abroad of technologies appropriate to local conditions.

e. Increased employment – (use of labor-intensive technologies)

f. No balance of payment problems (exports > imports)

1.2 Export promotion – Disadvantages (AO3)

a. Exporting countries may become overly dependent on exports

- If trading partners encounter recession, export will fall → AD decrease → recession of its own.

b. Workers may not benefit from export growth

- Efforts to maintain low wages to keep labor costs low, so that exports could be more competitive.

c. Strong exports over a long period of time (trade surplus corresponding to trade deficits in trading partners) → **trade protection by the trading partners.**

1.3 Economic integration

Economic Integration – economic interdependence between countries, usually achieved by agreement between countries to reduce or eliminate trade and other barriers between them.

- Preferential trade agreements
- Regional free trade agreements (FTAs)

- There has been a very large increase in the number of bilateral and regional trade agreements around the world.
  (20 in 1990 → 159 in 2007 → 270 by 2019)
- E.g. **MERCOSUR** (Latin America), **ASEAN** (Southeast Asia), **CEMAC** (Central Africa, **CAIS** (Central America, **COMESA** (Eastern & Southern Africa)

- **Reasons:**
  - Slow progress made by the WTO
  - For developing countries: possibilities of enjoying the benefits of free trade, bypassing obstacles created by rich country trade protection, while maintaining some of the benefits of trade protection (toward non-members)

1.3 Economic integration - FTAs
- Potential benefits for growth and dev’

FTAs can help developing countries achieve growth and dev’ when they involve:

- Regional agreements
- Geographical closeness

→

- Expand their markets & achieving economies of scale → Increased domestic and foreign direct investment
- Diversify production and exports

- Similar level of development and technological capabilities
- Similar market sizes

→ More ‘fair’ competition (no unfair competitive advantage caused by lower cost due to use of more advanced technologies, greater managerial know-how, larger firm size due to larger home markets

- Shared commitment to co-operation → Easier to jointly pursue mutually beneficial policies (e.g. transport infrastructure, energy&water supplies, R&D projects, new technology dev’, environment improvement

Recall: advantages of FTAs

① Trade creation
② Increased Competition
③ Expansion into larger markets
④ Economies of Scale
⑤ Lower prices for consumers and greater consumer choice
⑥ Increased investment
⑦ Better use of factors of production: improved resource allocation and greater employment opportunities
⑧ Improved efficiency in production and greater economic growth
⑨ Strong bargaining power
⑩ Political advantages

1.3 Economic integration - FTAs

- Potential risks for growth and dev’

Bilateral trade agreements between developing and developed countries may:

- Require equal & matching cuts in tariff and other barriers → put firms (even efficient one) in developing countries at a competitive disadvantage because they are forced to compete with a lower cost developed country. → increase in imports
- If many developing countries form FTAs with the same developed country to gain market access, they must all compete with each other for the developed country market → increase in exports may be limited.
- Increased imports & slightly increased exports → trade deficits and increasing foreign debt → greater unemployment, worsening income distribution and increased poverty.
- Weaker bargaining power for developing countries puts them at a disadvantage in bilateral negotiation. (in multilateral negotiation of the WTO, they can join together and present their interest)
- The developing country must agree to other requirements that may not be in its best interests. (freer rules on FDI, stricter rules on copyrights & patent laws)
- Bilateral agreements divide developing countries by creating different interests. It also weaken regional trade agreements when a member country make a bilateral agreement with a third country.

Recall: disadvantages of FTAs

① Trade diversion

② Trading blocs may be a challenge to multilateral (WTO) trading negotiations (trade liberalization)

③ Unequal distribution of gains and possible losses

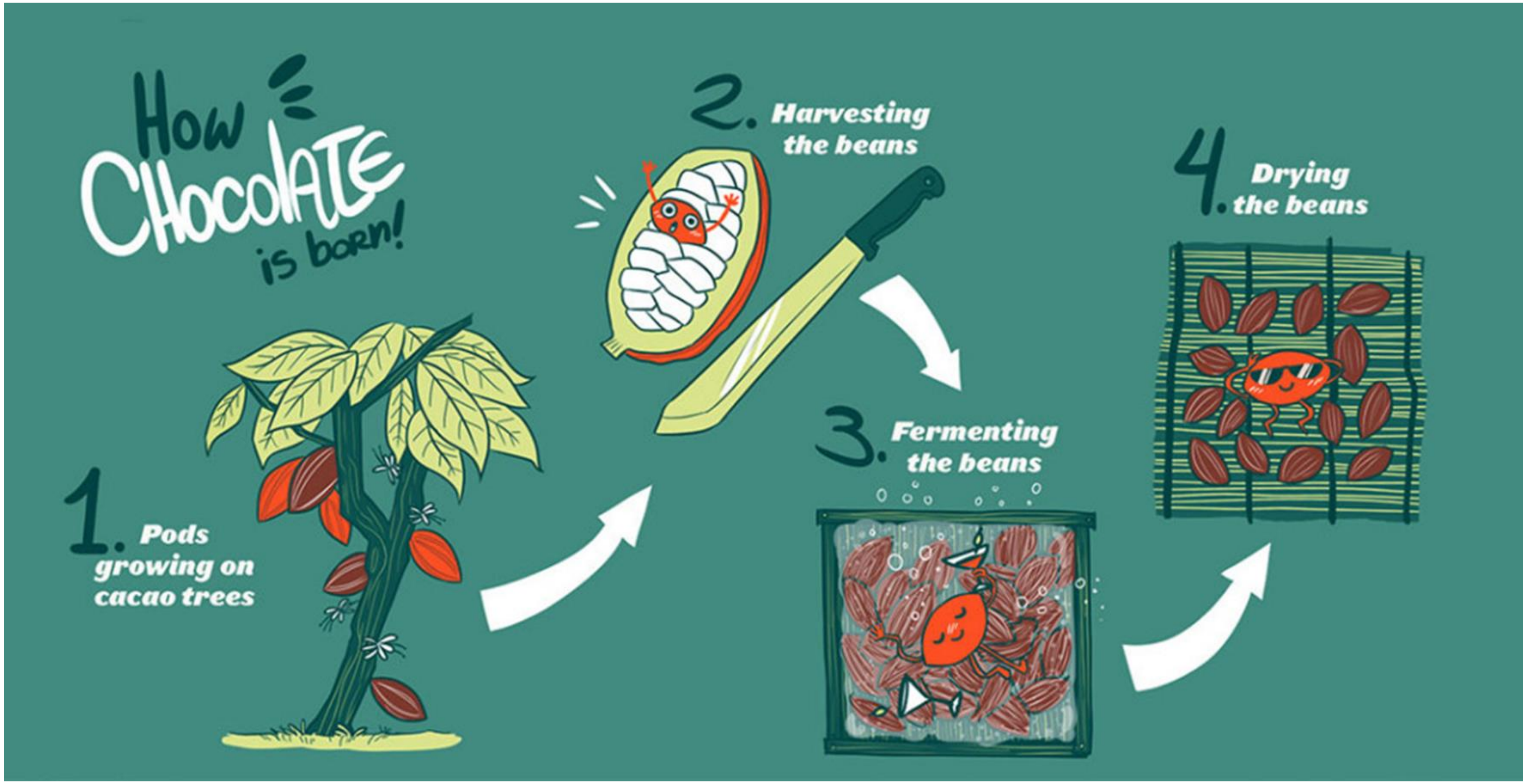
④ Economic integration involves a loss of sovereignty

1.4 Trade liberalization

Trade liberalization will be discussed later in connection with market-based policies

2. Diversification and Social Enterprise

The country produce and export cocoa beans
→ Cocoa bean market



Primary sector

Export the primary commodities in their "raw" forms.

The country produce and export dark chocolate → Chocolate market

"Value added" - refers to the value of a good that is added in each step of a production process.

Diversification of production

into value added manufacturing sector.

The country produce and export cake → Cake and pastries market

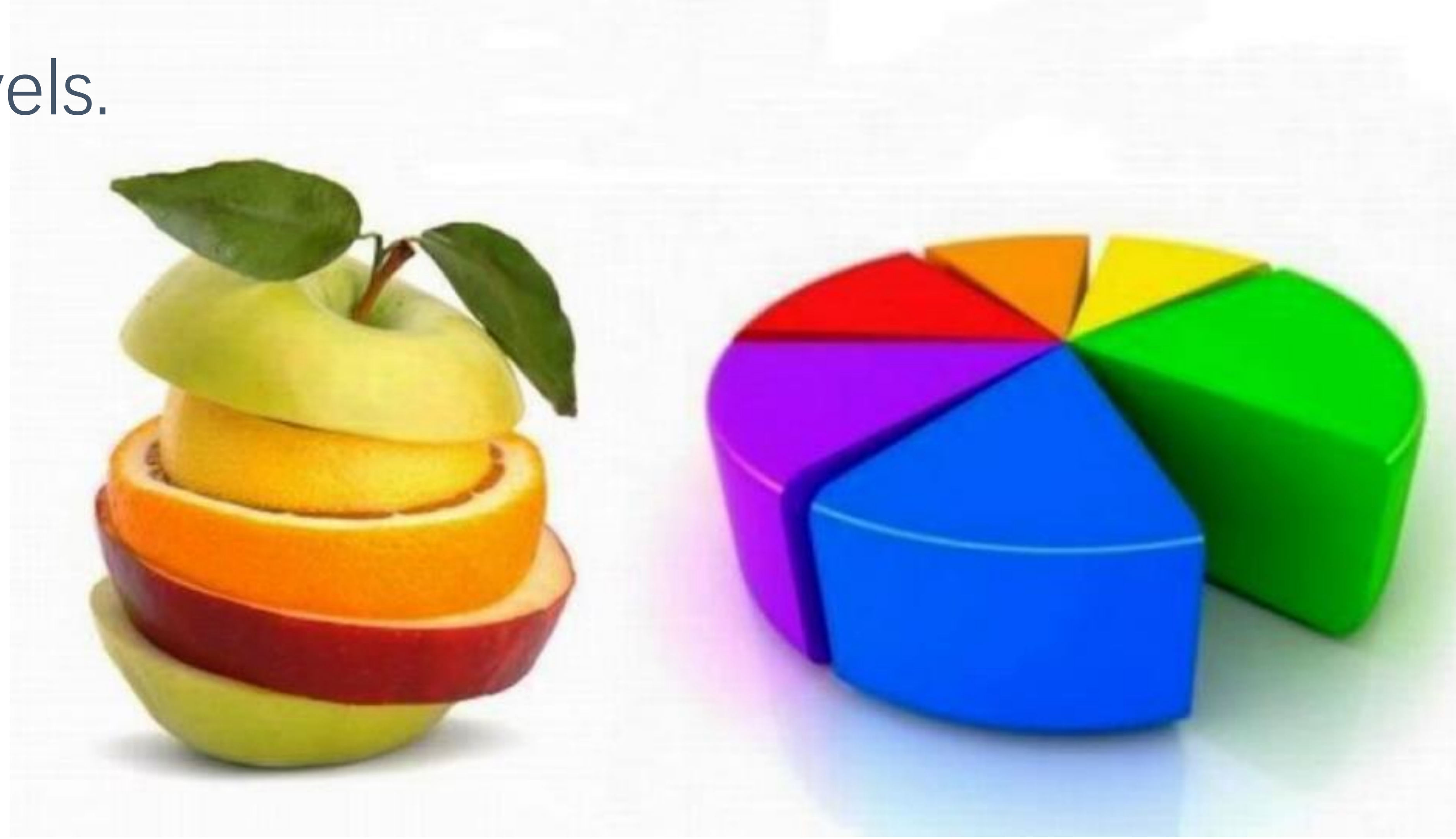
Each step adds value to the cocoa beans (primary commodity) and diversifies into chocolate and baking manufacturing.

2.1 Diversification of economic activity

Diversification involves a reallocation of resources into new activities that broaden the range of goods or services produced.

- As the country diversifies from primary sector into manufacturing and service sectors, expands into higher value-added production → its exports are likely to become more varied accordingly.
- **Benefits:**
  - ✓ Engaging in more varied production activities
  - ✓ Creating employment opportunities
  - ✓ Establishing new firms involving with manufactured goods
  - ✓ Expanding into activities requiring higher skill and technology levels.

➢ **Be caution of "too much specialization"**: If a country has a comparative advantage in the production of primary products, overspecialization would seriously limit its growth and development prospects.



2. Diversification and Social Enterprise

2.1 Diversification of economic activity

Overspecialization versus diversification

- "Curse of natural resources"
  - **Resource-rich countries** overspecialized (heavily dependent) in a narrow range of primary commodities → it will be a major barrier to growth and development.
    - ➢ short-term volatility of export revenue, possible of external borrowing, accumulation of large debt and BOP difficulties
    - ➢ E.g. Russia (rich in oil, natural gas, metals and timber); Venezuela (rich in oil); Sierra Leone (Rich in mineral deposits); South Africa (rich in oil and mineral deposits), etc.
  - **Resource-poor countries** achieve better performance due to earlier diversification into manufacturing sector
    - ➢ labor-intensive manufacturing, together with investments in human capital and appropriate technologies)

→ Resource-poor developing countries have been growing faster than resource-rich countries.

2.1 Diversification of economic activity

The benefits of diversification

- ✓ **Sustained increases in exports**
  - Diversification into markets with a sustained increase in global demand, which commodity exports do not satisfy.
- ✓ **Development of technological capabilities and skills**
  - Diversification provides incentives to acquire:
    - Technologies
    - Higher training, education and skill levels
- ✓ **Reduced vulnerability to short-term price volatility**
  - It protects countries against losses from fluctuating export prices.
- ✓ **Use of domestic primary commodities**
  - Domestic availability of the necessary raw materials can work to stimulate industry.

2. Diversification and Social Enterprise

2.2 Social enterprise

A social enterprise is a type of commercial organization that aims to achieve particular social goals to **improve people's well-being** and **promote social change**.

- Either **for-profit** or **not-for-profit** organizations.
- For those for-profit organizations, their primary goal is still their social goals, but they also try to be commercially viable (cover all costs) rather than rely on grants or donations. The profits will be put back into the enterprise.
- They operate in a **broad variety of areas**, including education, health, social care, agriculture, fisheries, forestry, energy, clean technology and transport, microfinance.
- Social enterprise becoming increasingly popular in **developing countries**. (anti-poverty programs, etc.)

➢ *Read "real world focus 20.1 in textbook P808*

3. Market-based policies

-Trade liberalization, privatization, deregulation and more

3. Market-based policies

Trade liberalization: the policy of liberalizing (freeing up) international trade by eliminating trade protection and barriers to trade (i.e. tariffs, quotas, etc.)
→limited government intervention & competitive free market

- **Washington Consensus** (a term coined by John Williamson) is a set of economic policy recommendations for developing countries, and Latin America in particular, that became popular during the 1980s.
- **Key**: free up markets & cut back government intervention
- It was shared by the World Bank, The International Monetary Fund, The United State Congress, and a number of US agencies). **Main policies recommended**:
  - **Trade liberalization** involving moving to free trade by lowering and eliminating tariff and other barriers to trade.
  - **Privatization of state enterprises**, such as transport, oil, gas
  - **Deregulation of labour and product markets**
    - market-based supply-side policies for labour, such as reducing labour union power and unemployment benefits, reducing/eliminating minimum wages
    - Removing barriers to enter product markets
  - **Encouraging floating exchange rates**; no exchange rate management
  - **Reduced restriction to FDI** by multinational corporations
  - **Limited borrowing by the government**, keeping budget deficits under control
  - **Restricting the use of industrial policies**

3. Market-based policies

The effects of economic and trade liberalization

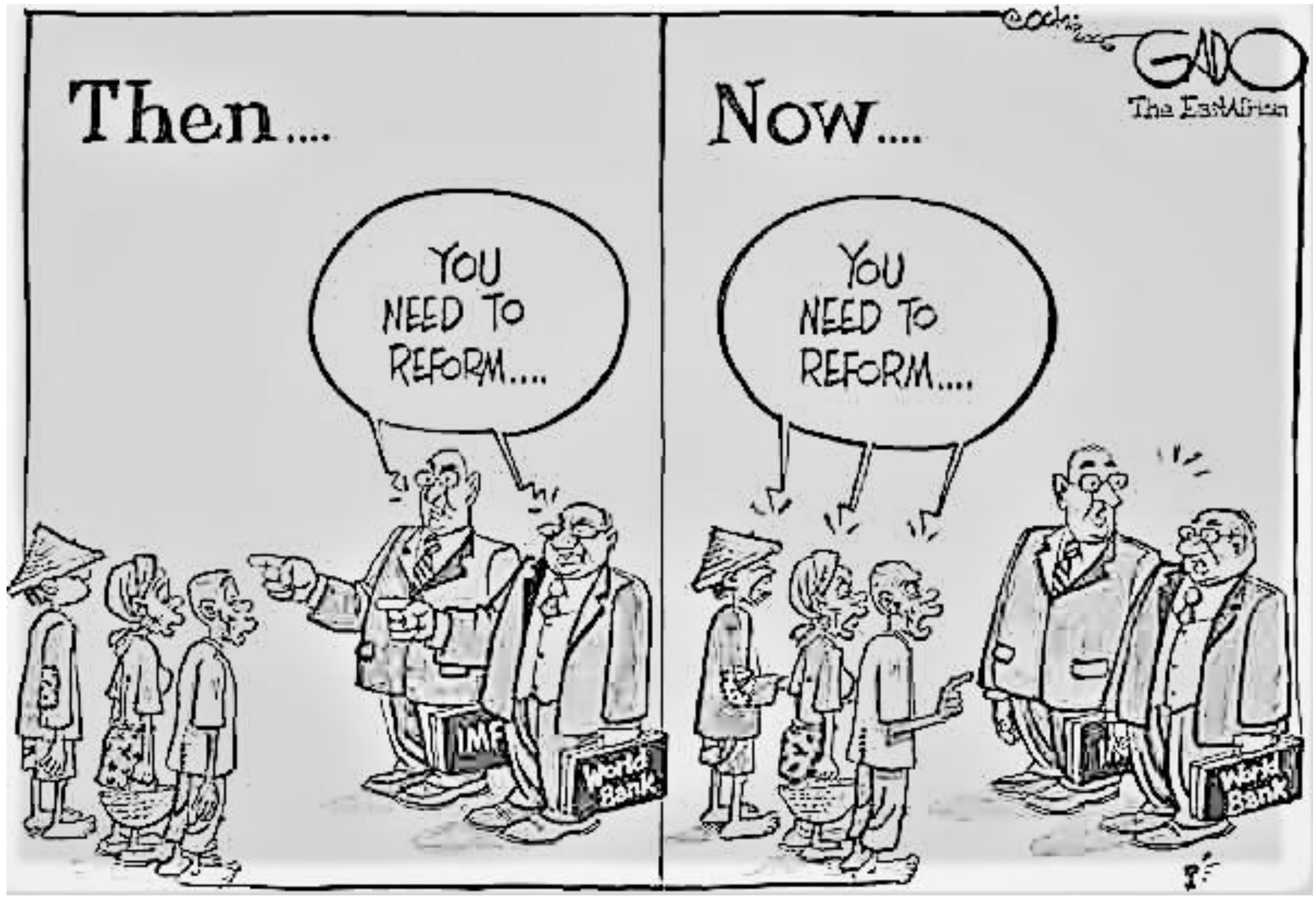
a. **Limited benefits for export growth and diversification** – liberalization did not help developing countries diversify production into increased manufacturing.

Reasons:

- Trade protection policies of developed countries on developing country exports, including protection of agriculture and tariff escalation.
- Growing reliance on free market policies (with less government support, many developing countries were not able to perform well)

b. **Limited effects on economic growth.**

- No evidence shows there is clear link between trade liberalization and economic growth.



3. Market-based policies

The effects of economic and trade liberalization

c. Increasing income inequalities and poverty within developing countries

- Trade liberalization leads to lower income growth among the poorest 40% of population, but higher income growth for the higher income groups.
- **People who are better off:**
  - Those find employment in the production of export goods
  - Those who find jobs in a growing formal sector
  - People with some education and skills, because they are better able to exploit new opportunities in the more competitive environment.
- **People who are worse off:**
  - Less educated or illiterate people, who are unable to compete in the new environment
  - Poor people who lack collateral (wealth), and who cannot get credit to open or expand a business to take advantage of new opportunities
  - People in remote geographical areas with no transport links to markets
  - People who have nothing to export, and no possibilities of producing for export
  - People in agriculture who switch to producing commodities for export (vulnerable to commodity price fluctuations)
  - People who lose their jobs as public employees due to cutbacks in the public sector.
  - People who lose their jobs in the private sector as firms close when they are unable to compete with imports of products produced by large firms in richer countries
  - People who become unemployed due to privatization of public enterprises, which fire workers to lower costs.
  - People affected by cuts in government spending on merit goods
  - People affected by lower levels of social protection caused by supply-side policies (lower minimum wages, lower unemployment benefits, etc.)
  - People forced into the informal economy with lower wages and zero social protection.

3. Market-based policies
A new consensus

A new consensus → trade and market liberalization with government intervention

- Mix of markets with government intervention to support growth and development, government should:
  - **support education, health services and infrastructure development**, as well as R&D and transfer of technology for both industry and agriculture.
  - **Avoid large budget deficits**
    - If contractionary fiscal policy is needed, it should not affect spending on education, health and infrastructure.
  - pay attention to the effects of policies on **income distribution**. (pursue policies that promote income equality and alleviation of poverty)
  - provide a proper **regulatory framework** for markets to work effectively.
  - **Promote institutions** such as property and land rights, an effective tax system, and effective banking and credit system.
  - Developed countries must assist economic development by increasing **foreign aid** and providing increased **access to their markets** for developing country exports.
  - Developing countries should receive **special treatment** by international trade agreements under the WTO regarding removal of rich country trade protection measures.

➢ Government intervention is important as it can help create the conditions for markets and trade to work to the advantage of developing countries.

4. Interventionist policies: redistribution and provision of merit goods

4 Interventionist policies

4.1 Redistribution policies

- Tax policies
- Transfer payments
- Minimum wages

4.2 Provision of merit goods

- Education and health services
- Infrastructure

4.1 Redistribution policies

4.1.1 Tax policies

- IMF recommends that developing country governments should:
  - Increase the **progressivity** of the tax system.
  - Gradually expand the **coverage of personal income taxes**
  - Expand the use of **indirect taxes** on luxury goods and goods that create negative externalities.
  - Increase taxation from **capital income** (profits), which is essential to ensure progressivity.
  - Impose or increase **taxes on real estate and land**
  - Take measures to **reduce tax evasion**

4.1 Redistribution policies

4.1.2 Transfer payments – important method used to improve income distribution and reduce poverty.

Some typical types of transfer payments:

- **Conditional cash transfers (CCTs)** – money paid on condition that the households receiving the money undertake activities related to education and health care, often for children. (real world focus 6.1)

- **Non-conditional cash transfer** do not impose restrictions, providing flexibility to households to manage their expenditures freely in accordance with their needs.

- **"Universal social protection"** called by the World Bank and International Labour Organization (ILO). Access by an entire population to social protection which includes child benefits, pensions for older persons, benefits for maternity, disability work injury or unemployment.
  - Costly, many developing countries cannot be fully implemented over the short term
  - Their full effectiveness depends on government policies to address the crucially important issues.
  - Difficulties in the design and implementation so that the money will reach the population groups that are most in need.

4.1 Redistribution policies

Benefits:

- Reduce poverty and encourage social inclusion
- Empower individuals and encourage them to make decisions that reflect their preferences rather than the preference of the government or aid or development organisations.
- Increased incomes → increased demand for locally produced goods, thus also helping local producers.
- Increased incomes, consumption and investment → increased AD → Economic growth
- Help provide safety against sudden hardships or emergencies
- Improve access to health care and education
- Encourage empowerment of woman, and delayed marriage
- Reduce malnutrition and child mortality
- Help bring the poor into the formal economy
- Result in reductions of child labour
- Build political stability and reduce social tensions
- It do not reduce the incentive of adults to work.

4.1 Redistribution policies

4.1.3 Minimum wages

- Purpose – support incomes of unskilled workers
- In theory, it leads to unemployment.→ market-based supply side policies emphasized reducing or eliminating minimum wages to increase employment in the 1980s and 1990s.

In practice, such job losses do not occur unless minimum wages are set at very high levels

→ Many countries introduced or increased their minimum wages in 1990s.

→ Question arise **as how to best design a minimum wage system**

- It should be set by governments after consulting with representatives of workers and employers in order to take all relevant points of view into account.
- It's important to consider the needs of workers and their families, to monitor and evaluate the effects, to have a mechanism allowing possible changes every year or two in order to make necessary adjustments.
- It's important to establish measures to ensure compliance and enforcement, to avoid work at wages below the legal minimum.

4.2 Provision of merit goods

4.2.1 Education as merit goods (with positive externalities for growth and development) results to:

- **Economic growth** - The benefits of education extend to society in the form of increased labour productivity & greater output
- **Improvements in the quality of physical capital** (i.e. technological advances) – knowledge apply to R&D, to the development of technologies appropriate to local economic, ecological and climate conditions.
- **Lower unemployment, lower absenteeism from work, increased international competitiveness; and it attracts foreign direct investment**
- **Increased political stability** (important condition for economic growth and development)
- Further social benefits, such as **lower crime rate** and a **better quality of life**.
- **The education of women** → women's participation in the labour force, lower birth rates → lower rates of population growth and reduction of poverty.

- **Benefits of education spill over into health:**
  - Education of women → improvements in maternal health and reduction in maternal mortality.
  - Education of mothers → improved health care, better nutrition, lower children mortality → healthier children
  - Schools teach children basic principles of hygiene and sanitation → healthier children and family members.

4.2 Provision of merit goods

Importance of elementary education and universal literacy

- One of the most important investment in education involve achieving **universal literacy rates**.
  - Pursue high literacy rates (primary school education) → gradually increasing investment in secondary and university education in line with developments in technological capabilities.
  - Successful case: China, Indonesia, South Korea, Thailand, etc.

- Some developing countries **invest too heavily in higher education**, while ignoring the basic elementary level which results in:
  - An international brain drain – university graduates from developing countries migrate to developed countries (loss of human capital)
  - An internal brain drain
    - Highly educated individuals cannot find suitable employment, therefore find job requiring lower skill levels.
    - Doctors and medical personnel educated in government-funded institutions do not work in public medical institutions (serve lower income groups), but work in the private sector (serve wealthy patients)
    - Highly educated individuals apply their skills to research and technology development in areas that are more relevant to the needs of developed countries (more prestigious), while ignoring local technological needs (building low-cost schools, hospitals, etc.)

4.2 Provision of merit goods

4.2.2 Health care as merit goods (with positive externalities for growth and development)

results to:

- Greater work productivity → greater output & economic growth
- Lower risk of spreading diseases to the community
- Immunization benefit the community by lowering the risk of contracting a disease.
- Healthier people provide more benefits to the community through more active and productive participation.

- **benefits of higher levels of health spill over into education**, with:
  - Higher level of health and good nutrition → better school attendance and performance in school → longer time spent in school.
  - Healthier individuals make better use of the knowledge and skills they possess.
  - Better health → longer lifespan → The benefits of education can affect the economy and society for a longer time.

4.2 Provision of merit goods

◆Appropriate intervention in education and health care services.

- ◆Direct government provision.
- ◆Government legislation and regulation making education compulsory up to a certain age.
- ◆Nudge – advertising and persuasion

- ◆Public service of education and health care must be:
  - ✓Universal (everyone have access to them)
  - ✓Free at the point of use
  - ✓Public, provided by government
  - ✓Able to prioritize services important to women, and promote women as workers.
  - ✓Accountable to those they serve.

4.2 Provision of merit goods

4.2.3 Infrastructure

- ➢ *SDG 6 "Ensure availability and sustainable management of water and sanitation for all"*
- ➢ *SDG 9 "Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation"*

- **Infrastructure increases productivity (output per worker) and lowers costs of production.**
  - ➢ **Good transportation system**
    - ✓ save time and effort in transporting goods and services
    - ✓ More output to be transported, lower cost of production.
  - ➢ **Effective telecommunication**
    - ✓ Faster and easier communications
    - ✓ Enable economic activities to be carried out more efficiently.
  - ➢ **Irrigation**
    - ✓ Higher yields (output per unit of land) and expansion of agricultural output
- **The availability of infrastructure facilitates modernization and diversification of the economy.**
  - ➢ **Electronic communication and data exchange**
    - ✓ More efficient practices and expansion of manufacturing, financial services and government economic activities.
  - ➢ **Power (electricity)**
    - ✓ Electrically power machines and equipment → Increases in worker productivity
  - ➢ **Safe water sources, sanitation and sewerage**
    - ✓ Permits countries to diversify into the production of processed foods.

4.2 Provision of merit goods

4.2.3 Infrastructure

- *SDG 6 "Ensure availability and sustainable management of water and sanitation for all"*
- *SDG 9 "Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation"*

- **Infrastructure provides services that are essential for maintaining a basic standard of living.**
  - **Safe water supplies, sanitation and sewerage systems**
    - ✓ higher levels of health of a population
    - ✓ Contribute to the reduction of avoidable illnesses and premature deaths.
  - **Transport services affect health and education**
    - ✓ They bring people in remote rural areas closer to education and health facilities.
    - ✓ They increases employment opportunities by allowing the movement of people across longer distances → increase incomes and contribute to the alleviation of poverty.
    - ✓ It facilitates access to markets, reducing the time and cost of transporting goods. (help people in remote and isolated rural areas)
- **Infrastructure of water supplies with infrastructure supplying energy (electricity and gas), have major impacts on gender equity.**
  - Without them, women and girls are forced to spend a large proportion of their time carrying water and fuel-wood
  - With more free time,
    - ✓ Increased school enrolment for girls
    - ✓ Increased women employment outside the home
    - ✓ Reduced fertility (fewer children in the family) → reduced poverty

4.2 Provision of merit goods

4.2.3 Infrastructure

- ➢ *SDG 6 "Ensure availability and sustainable management of water and sanitation for all"*
- ➢ *SDG 9 "Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation"*

- **Infrastructure of safe energy sources** (electricity and gas) **results in less indoor air pollution** (burning of polluting fuels for cooking and light)
  - ➢ Strong positive effects on the health of women and children, who spend more time indoors.
- The **introduction of irrigation over large areas** → increasing yields similarly increases incomes and contributes to raising people out of poverty.
- **Construction and maintenance of infrastructure** → create employment opportunities of construction and maintenance → increasing incomes.

5. Foreign direct Investment(FDI) and Multinational Corporations (MNCs)

FDI & MNC

- **Foreign direct investment (FDI)** is investment by firms based in one country (the home country) in productive activities in another country (the host country) with control of at least 10 per cent of the firm in the host country.
- A firm that undertakes foreign direct investment is referred to as a **multinational corporation (MNC).**

Geographical distribution of foreign direct investment inflows, 2017

Host region	% of world	% of developing countries
World	100.0	
Developed countries	49.9	
Developing countries	46.9	100.0
Africa	3.0	6.4
Asia	33.3	70.9
Latin America and the Caribbean	10.6	22.6
Transition economies*	3.3	

* Include South East Europe, the Commonwealth of Independent States, Georgia

- FDI remains a small share of total private investment in developing countries, but FDI is **qualitatively very different from local investment**, because of their:
    - Large size
    - Significant economic and political power
    - Superior technical and managerial expertise, know-how and technologies.

* FDI is the most important source of foreign finance flows to developing countries. But for many low-incoming developing countries (completely bypassed by MNCs), foreign aid is the main source of foreign finance.

Why MNCs expand into economically less developed countries

- Developing countries offer possibilities for MNCs to:
  - Increase sales and revenues in developing countries with large or rapid growing markets. (e.g. China, India, countries in Latin America)
  - Bypass trade barriers and secure access to local markets.
  - Lower costs of production. Developing countries generally have lower labour costs.
  - Use locally produced raw materials. It is far less costly to obtain them locally than to import them.
  - Further their activities in natural resource extraction. Many developing countries are very rich in natural resources.

Why MNCs expand into economically less developed countries

- **Developing country characteristics that attract MNCs:**
  - Political stability and a stable political environment
  - A stable macroeconomic environment: low inflation, stable currency, acceptable levels of foreign debt, absence of major balance of payment problems.
  - Favorable tax rules (to ensure low tax payments)
  - Weak labor protection laws (lower cost of labor)
  - A liberalized economy and trade policy with an emphasis on exports
  - Large markets
  - Rapid economic growth and expectations of continued rapid growth
  - Well-functioning infrastructure, including transportation and communications, to facilitate imports and exports
  - A well-educated labor force.

Why MNCs expand into economically less developed countries

- Potential advantages of MNCs for host developing countries
  - **MNCs can supplement insufficient foreign exchange earnings**
    - FDI act as credits in the financial account, and can help offset a current account deficit.
    - MNCs are usually export oriented, increased export earnings give credits to the current account.
  - **MNCs can supplement and improve upon local technical skills, management skills and technology.**
    - The technical and managerial expertise, new production technologies of MNCs can be learned and adopted by the local labour force (workers and managers) and local businesses.
  - **MNCs can supplement insufficient domestic savings and increase investment and new capital formation.**
  - **MNCs can lead to greater tax revenues in the host country.** (income tax, corporate tax, indirect tax, etc.)

Why MNCs expand into economically less developed countries

- **Potential advantages of MNCs for host developing countries**
  - **MNCs can help promote local industry**.
    - MNCs buy locally produced inputs → promote the development of local industries (growth of existing local firms or the establishment of new local firms)
  - **MNCs can increase local employment and help lower unemployment in the host country.**
  - **MNCs can lead to higher economic growth in the host country. (SR & LR)**
    - Increased levels of investment
    - Improved technology
    - Increased in human capital
    - Promotion of local industry
    - Greater tax revenues

→ Economic growth in the host country with increased possibilities for pursuing development objectives.

Why MNCs expand into economically less developed countries

Potential disadvantages of MNCs for host developing countries

The benefits mentioned above may not be achieved because:

- **MNCs may not always supplement insufficient foreign exchange earnings**. MNCs also engage in activities resulting in foreign exchange outflows:
  - Repatriation of profits.
  - MNC imports of raw materials and other inputs
  - MNC finance their activities by borrowing from the parent corporation in the home country (repay loans & interests)

  → Net inflows of foreign exchange (inflows-outflows) may be small
- **MNCs may not improve on local technical skills, management skills and technology**
  - MNCs often hire personnel from the home country.
  - Local workers do not have the opportunity to learn from the MNC.
- **MNCs may not lead to greater tax revenues in the host country.**
  - Host country provide tax privileges and benefits for MNCs → lower tax payment for MNCs
  - Transfer pricing: MNCs buy inputs from their various affiliates in other countries, claiming higher inputs price (higher than actual price paid), their profit appear lower, thus lower their tax payment (based on profit earned)

Why MNCs expand into economically less developed countries

Potential disadvantages of MNCs for host developing countries

The benefits mentioned above may not be achieved because:

- **MNCs may not help promote local industry.**
  - The operation of MNCs sometimes forces local competing firms to go out of business, or
  - Does not permit new local firms to establish themselves in the industry.
- **MNCs may not help lower unemployment in the host country.**
  - If MNCs prevent the development of local industry, the job-creating impact will be limited.
  - Some MNCs import capital-intensive technologies, thus contributing to unemployment and the growth of the informal economy.

  * (Some MNCs engage in labor-intensive activities that make extensive use of cheap local labor)

Why MNCs expand into economically less developed countries

Potential disadvantages of MNCs for host developing countries

- Further possible negative effects of MNCs
  - **MNCs and environmental degradation**
    - MNCs prefer to invest in countries with few environmental restrictions → engage in activities cause tremendous environmental damage.
      - Undertaking environmentally unsustainable activities
      - Industrial pollutants, such as chlorofluorocarbons, pesticides, plastics, petroleum, industrial chemicals, etc.
  - **MNCs promote inappropriate consumption patterns in developing countries.**
    - Inappropriate consumption patterns, such as soft drinks, sweets, fast foods, expensive brand name goods, etc.
    - People in developing countries still plagued by hunger, malnutrition, disease and lack of basic services. They are less affordable to spend their small incomes on unnecessary goods while their basic needs remain unsatisfied.
  - **MNCs may use government resources to build infrastructure needed by MNCs rather than for poverty alleviation.**
    - Host country government build infrastructure (road systems, ports, telecommunications, etc.) to make themselves attractive to MNCs.
    - Opportunity cost: shift resources away from needed merit goods and toward infrastructure for MNCs.

Why MNCs expand into economically less developed countries

Potential disadvantages of MNCs for host developing countries

- Further possible negative effects of MNCs
  - **MNCs may use their economic and political power to bring about policies that may work against economic development.**
    - MNCs prefer to invest in countries with weak labor protection laws → lower cost of labor
    - MNCs prefer to invest in countries with weak environmental regulations → avoid costs associated with environmental protection.
    - ➢ Host government find themselves in a weak bargaining position due to fear of lose the investment to another developing country.
  - **Competition between developing countries to host MNCs and the "race to the bottom".**
    - MNCs demands may conflict with what is in a country's best interests.
    - The desire to host MNCs may involve sacrifices in terms of needed policies for growth and development.


6. Foreign Aid

6. Foreign Aids

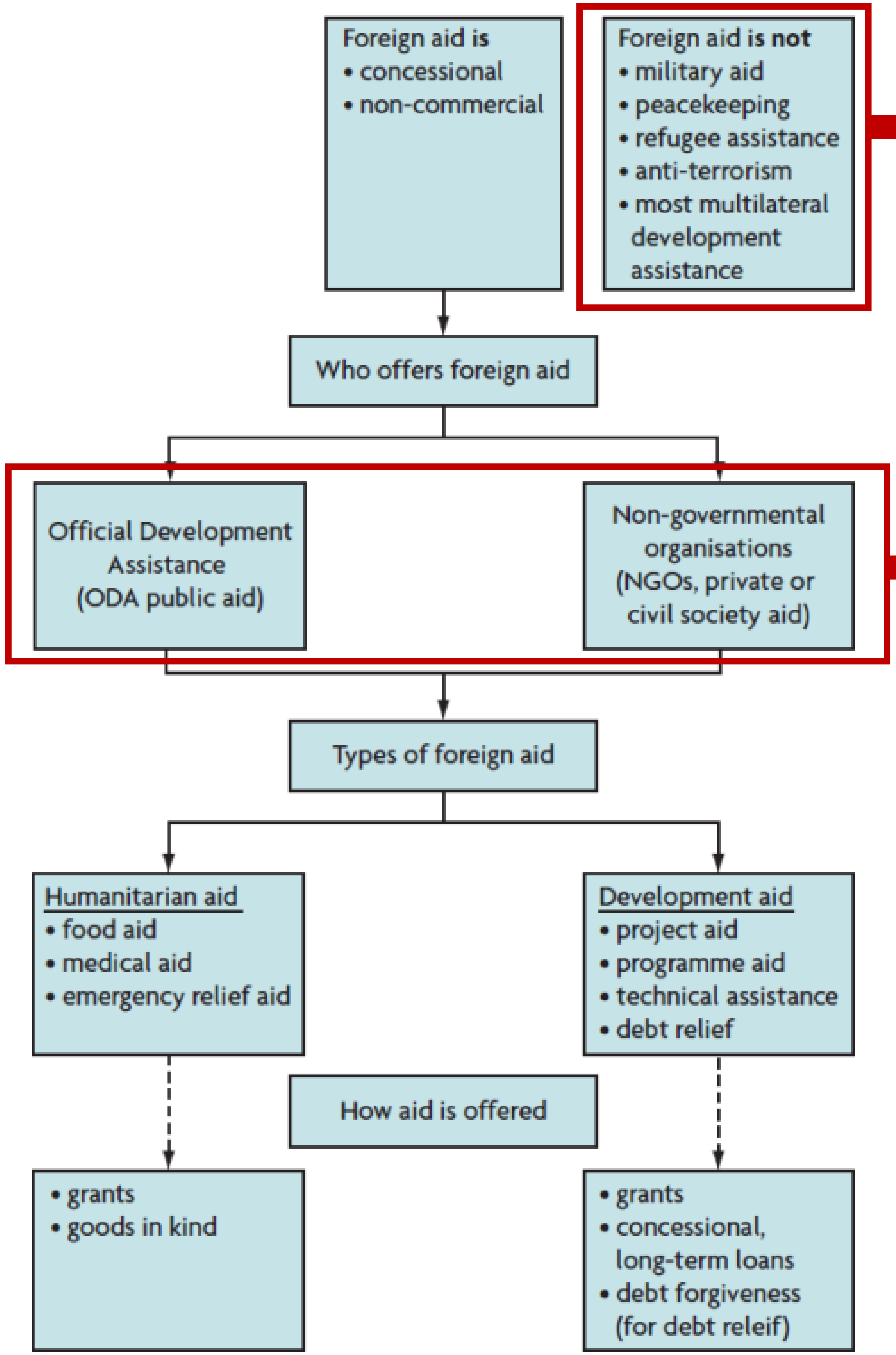
Foreign Aid is defined as the transfer of funds or goods and services to developing countries with the main objective to bring about improvements in their economic, social or political conditions.

- *SDG17.2 "Developed countries to implement fully their official development assistance commitments, including the commitment by many developed countries to achieve the target of 0.7 per cent of ODA/GNI to developing countries"*

Foreign Aid must be:

- **Concessional** - the transfers involve more favorable conditions than could be achieved in the market.
  - Loans with lower interest rates and longer repayment period compared with commercial banks.
  - Grants – gifts of money or goods/services that do not need to be repaid.
- **Non-commercial** – they must not involve buying and selling (commerce) or other activities concerned with making a profit.

Overview of Foreign Aid



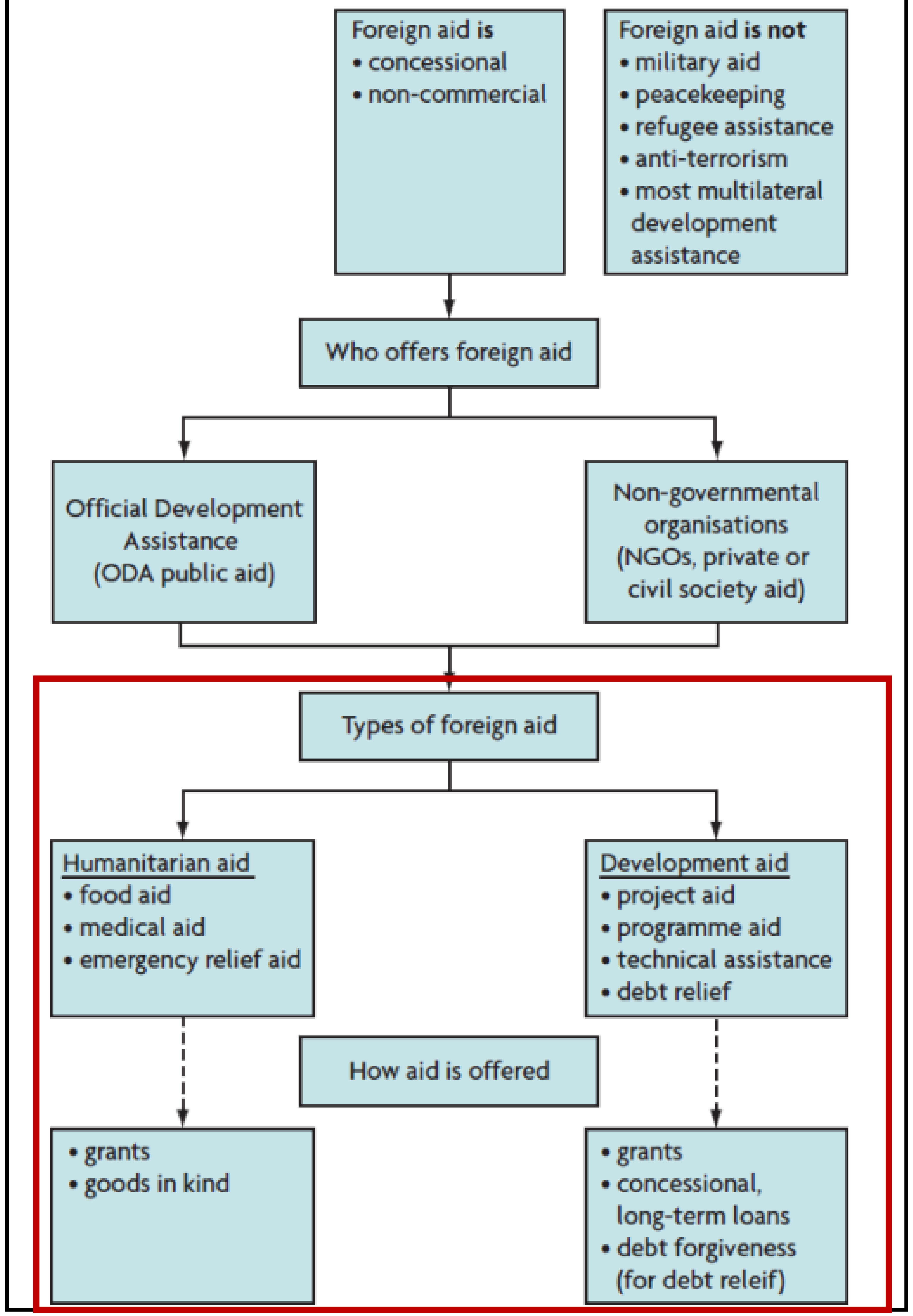
They do not count as foreign aid because they are not directly concerned with bringing about improvements in the economic, social or political conditions of developing countries.

Donors of aid (Source of aid):

- **Official Development Assistance (ODA)** – provided by developed country governments. – largest part of foreign aid, ¾ takes the form of grants
- **Private aid**: Aid provided by Non-Governmental Organizations (NGOs)

Recipients of aid: the developing countries that receive the aid.

Overview of Foreign Aid



Types of foreign aid (Offered both by ODA and NGOs)

- **Humanitarian aid** – it involves aid extended in regions where there are **emergencies caused by violent conflicts or natural disasters**.
  - **Aims**: to save lives, to ensure access to basic necessities, to provide assistance with reconstruction work in order to help displaced people cope.
  - **Offered as**:
    - Grants
    - Goods in kind.
- **Development aid** – intended to help developing countries achieve their **economic growth and development objectives**.
  - **Types**:
    - Financial support for special projects
    - Financial support to sectors
    - Technical assistance – technical advice by specialists such as doctors, teachers, agronomists, etc.
    - Debt relief.
  - **Offered as**:
    - Grants
    - Concessional long-term loans
    - Debt forgiveness.

Official Development Assistance (ODA)

Official Development Assistance (ODA) – provided by developed country governments.

- largest part of foreign aid, ¾ takes the form of grants.

- Three ways of ODA:
  - **through bilateral aid** – funds go directly from the donor government to the developing country recipient.
    - E.g. USAID(U.S) & DFID(U.K), members of OECD, OPEC, etc.
  - **through multilateral aid** – funds going indirectly from donor governments to international organizations, which transfer the funds to developing countries.
  - **Through NGOs –** donor governments transfer ODA funds to NGOs which spend them in developing countries.

✓ E.g. United Nations agencies, Global Fund to Fight Aids, Tuberculosis and Malaria, the International Development Association (IDA, an organization of the World Bank), regional development banks, etc.

✓ The international Monetary Fund (IMF) assistance for debt relief under debt relief initiatives.

Official Development Assistance (ODA)

Donor motives for providing ODA:

- **Political and strategic motives.**
  - Use aid to support regimes in developing countries that are considered to be "friendly" to the interests of the donor governments.
    - During the Cold War, US provided aid to restrict the spread of communism. The Soviet Union provided aid to communist states and non-communist states with communist leanings.
    - European powers provided aid to their former colonies.
- **Economic motives.**
  - Developed countries provide aids to assist developing countries which they have strong economic ties.
    - Japan provided aid to neighboring countries which has strong trade and investment links.
- **Humanitarian and moral motives.**
  - Short-term emergency assistance. E.g. in famines, wars or natural disasters.
  - Aid funds for long-term development purposes.

* FACTS: aid funds do not go to the countries that need them the most. Middle income developing countries receive 10 times as much aid per person in extreme poverty as lower income countries.

Private (civil society) aid: Non-Governmental Organisations (NGOs)

Non-governmental Organizations (NGOs) – private organizations that pursue activities to relieve suffering, promote the interests of the poor, protect the environment, provide basic social services, or undertake community development.

- Being "Private" – not part of any governmental structure.
- Being "not private" – not part of the market system.
- An expression of civil society, are often referred to as comprising a **Third sector** – first and second being the government and market sectors.

Private (civil society) aid: Non-Governmental Organisations (NGOs)

- NGOs involves concessional flows, but they are all grants. (no loans that must be repaid).
- **Funding from:** private voluntary contributions both from private sector corporations and bilateral and multilateral ODA funds.

- Wide variety or organisations:
  - Charitable organisations
  - Non-profit organizations
  - National based groups with a national or international reach
  - Locally based community groups
  - Grassroots organizations

- *Famous NGOs: Amnesty International, Greenpeace, Oxfam, Save the Children, World Wide Fund for Nature (WWF)*

Private (civil society) aid: Non-Governmental Organisations (NGOs)

The activities of NGOs:

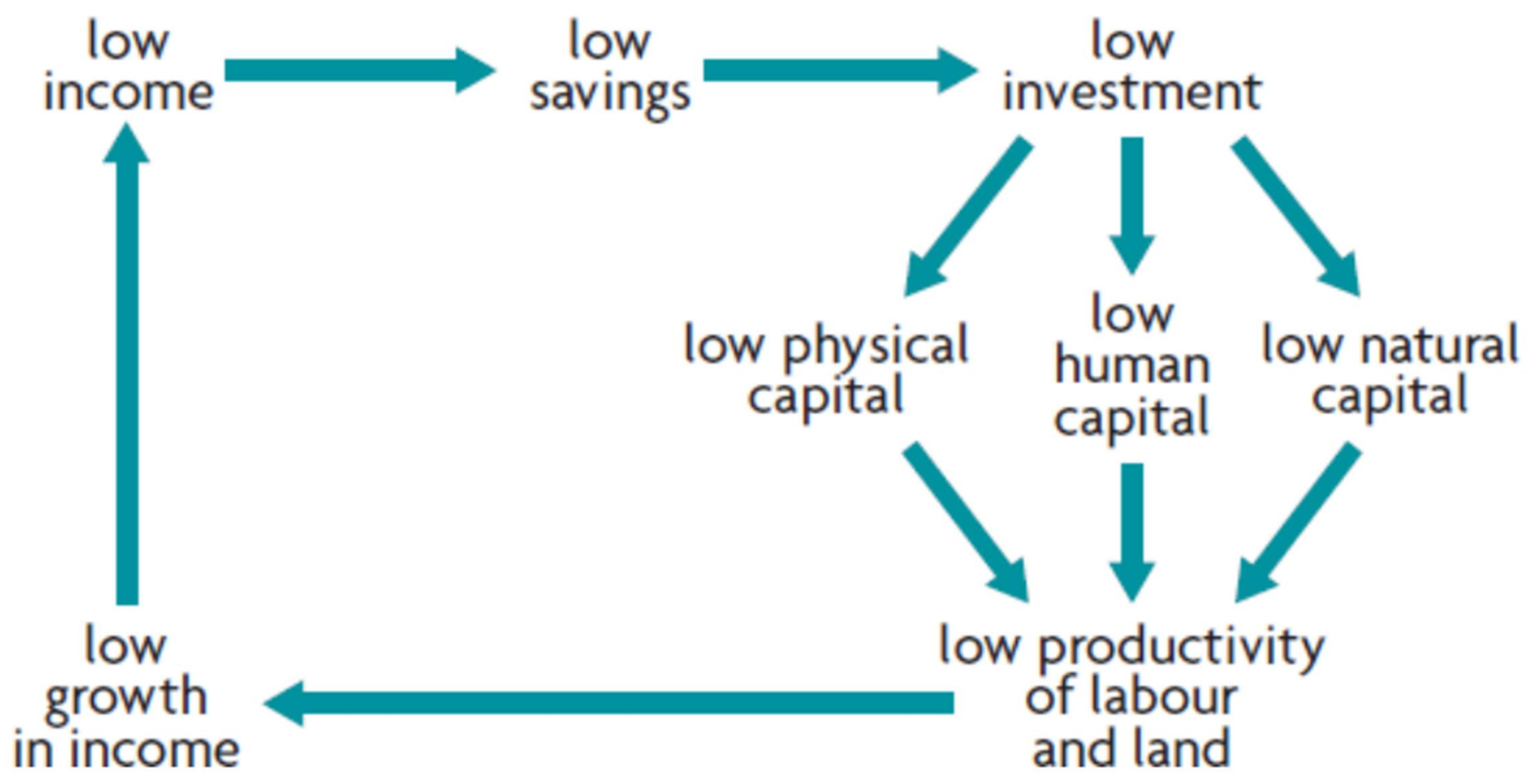
- Provision of humanitarian aid in times of crisis
- Promotion of sustainable development
- Promotion of community development
- Service delivery
- Poverty alleviation
- Protection of child health
- Promotion of women’s rights
- Promotion of small-scale entrepreneurs
- Support of the poor in the informal sector
- Provision of technical assistance to small farmers
- Provision of credit to poor people (microfinance)
- Research activities
- Political advocacy
- Support for people’s movements
- And so on.

Evaluating ODA
Advantages

1. **Aid and the poverty cycle**
   - Very poor developing countries do not have enough funds to make the necessary investments in health care, education and basic infrastructure to help people escape the poverty cycle.
   - Foreign aids provides the missing funds.

2. **Aid and provision of basic services**
   - Aid can make resource available for investments in health, education and infrastructure → higher employment opportunities and income for poor people.

3. **Aid and improved income distribution**
   - Helping the most disadvantaged groups in society → better relative income positions of the beneficiaries → improved income distribution.



Evaluating ODA
Advantages

4. Aid and economic growth

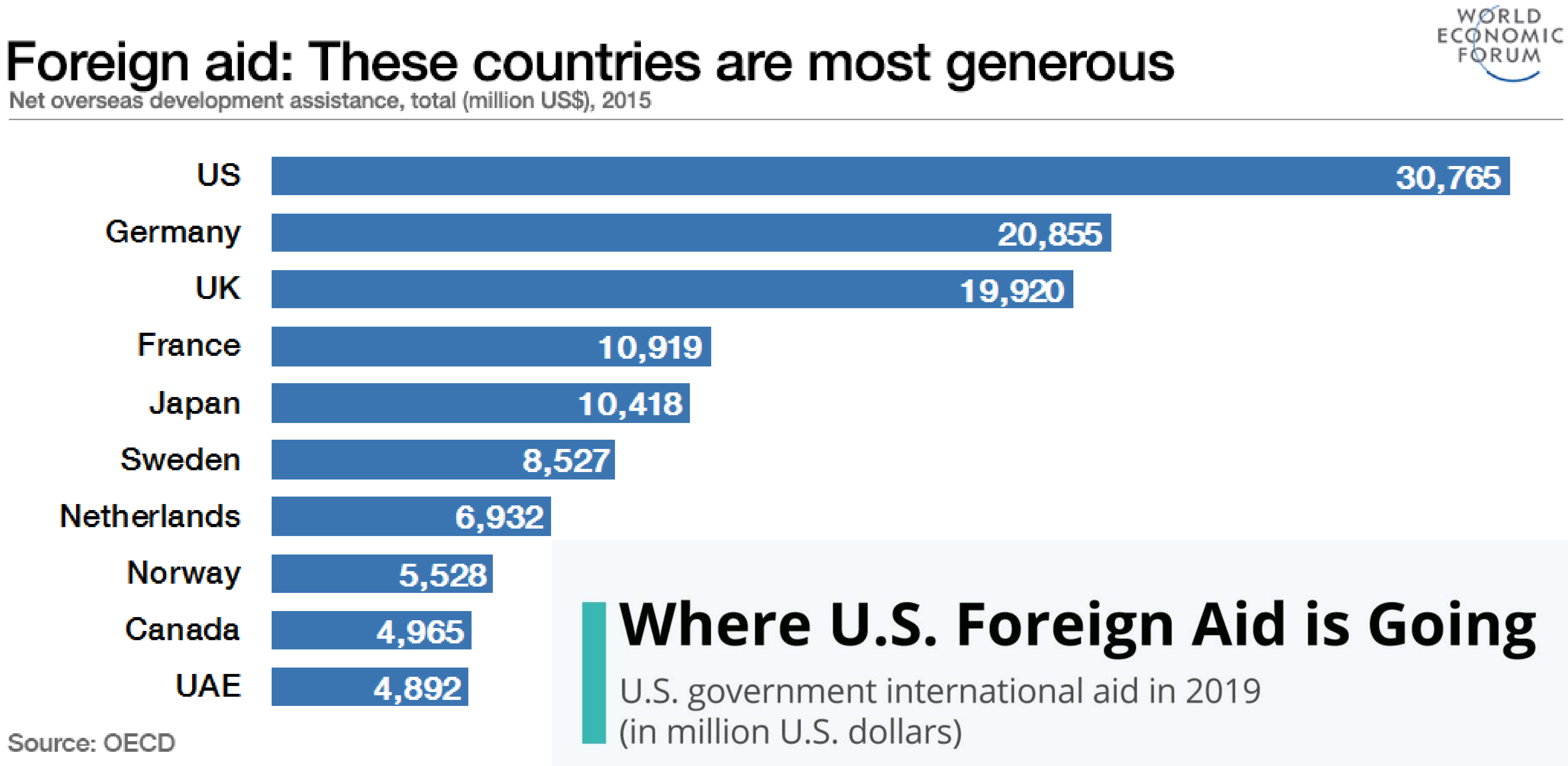
- Aid makes possible increased investment and consumption levels, leading to increased volumes of output.

5. Aid and the Sustainable Development Goals (SDGs)

- Much of aid is closely linked to the achievement of SDGs.

6. Aid, the debt trap and debt relief

- Countries that are caught in a “debt trap” must go on borrowing more and more in order to service old debts.
- Aid for debt relief helps countries reduce their debt burden → release resources for poverty reduction and economic growth and development



Evaluating ODA Disadvantages

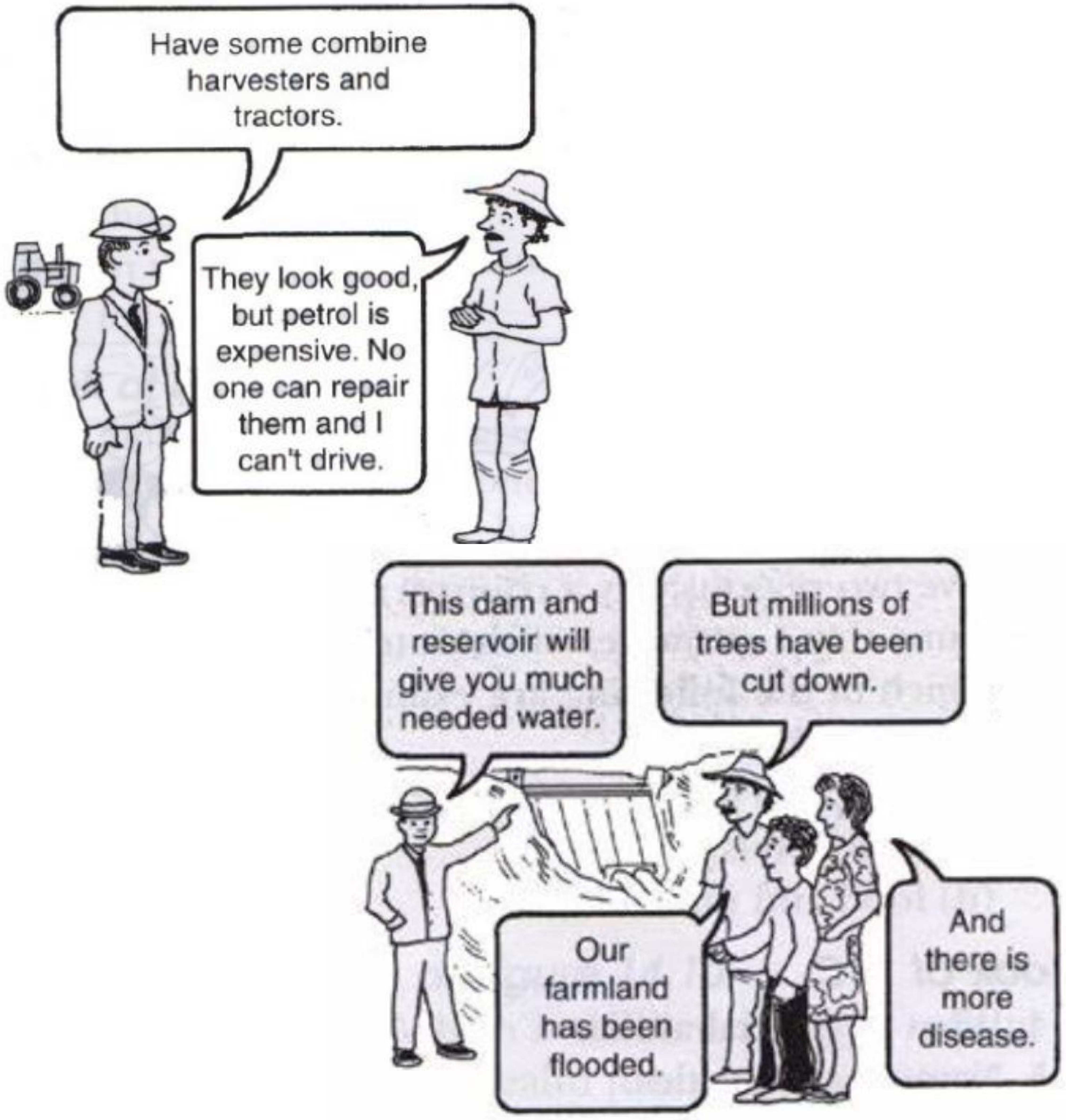
1. Tied aid

- Donors make the recipients of aid spend all or a portion of borrowed funds to buy goods and services from the donor country. (only in bilateral aid)
  - →Recipient countries cannot seek lower price alternatives for the goods/services they are forced to buy from the donor country → higher than necessary import costs.
  - →It often results in buying inappropriate, capital-intensive technologies.
  - →It is a kind of support for industry of developed countries, occurring at the expense of poor country development objectives.
  - *Real world focus 20.2*

Evaluating ODA
Disadvantages

2. Conditional aid (conditionality)

- Most donors of ODA impose numerous conditions that must be met by the recipients of aid.
- **Objectives of conditions**: act as mechanism for forcing developing countries to make important policy changes, also ensuring the aid funds are used effectively. E.g.
  - Policies to achieve a greater market orientation, such as privatization, elimination of trade barriers, etc.
  - Forcing the recipients to accept particular projects that the donors decide on.
- **Negative consequences**:
  - Donors do not pay sufficient attention to the preferences of the government or of the population groups the project is intended to benefit.
  - Policy prescriptions by donors may be incorrect
  - Policy may not fit in with the government's development strategy and priorities
  - Weakened recipient government's authority and accountability to its citizens.



Evaluating ODA
Disadvantages

3. Aid volatility and unpredictability

- Changing volumes of aid in donor budget and changing donor priorities on how to allocate aid funds → difficult for recipient governments to implement policies that depend on aid funds.
- It might cause serious effects in very poor countries that depend heavily on aid for provision of basic services.

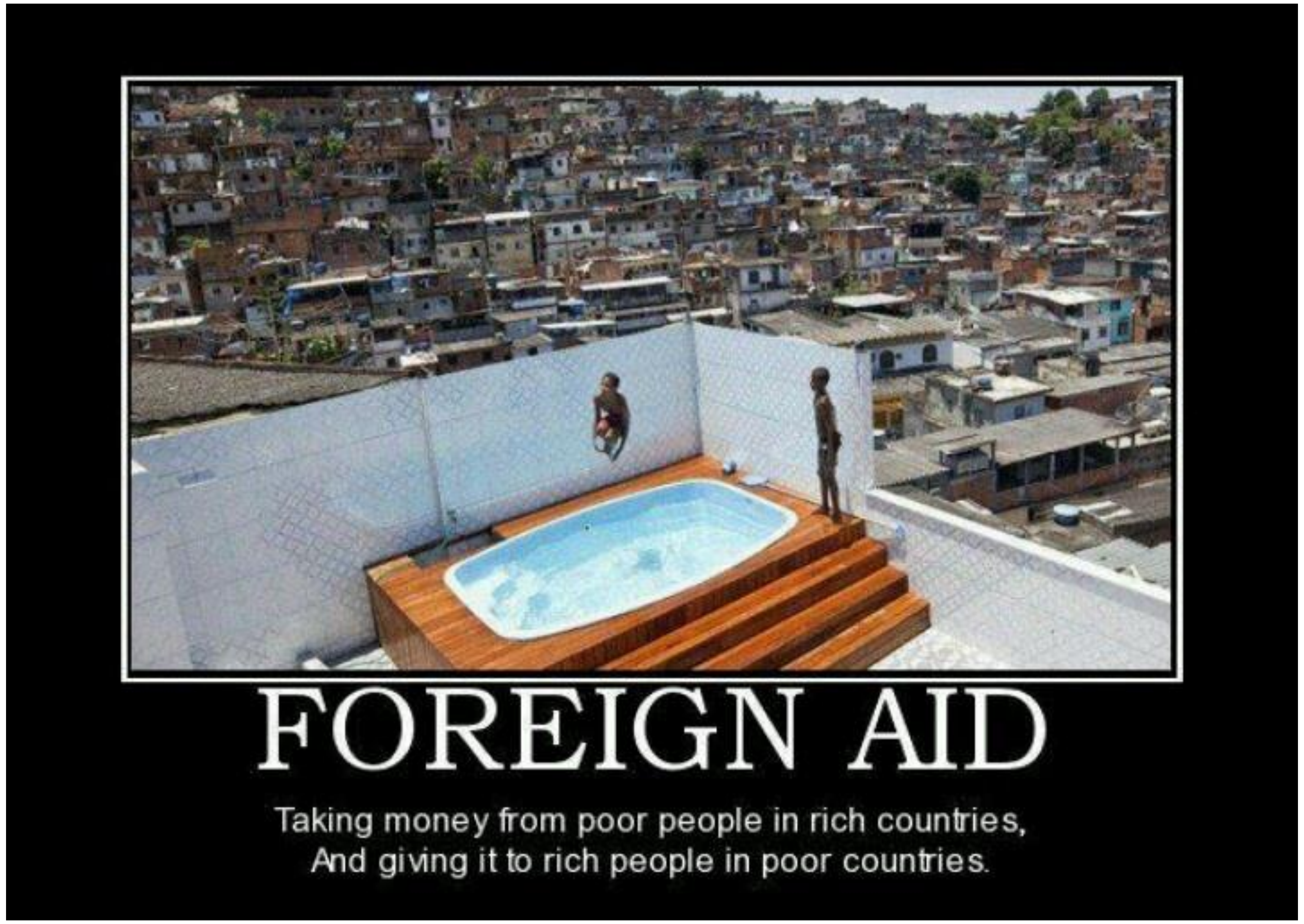
4. Uncoordinated donors

- Large numbers of donors (bilateral and multilateral) who finance uncoordinated activities → inefficiencies in the use of aid resources, such as:
  - Overlapping and duplication of projects
  - Inconsistencies between other projects
  - Lack of coherence in the entire aid effort.

Evaluating ODA
Disadvantages

5. **Aid may substitute for rather than supplement domestic resources.**
   - Aid resources are intended to supplement insufficient domestic resources.
   - Governments in recipient countries may use aid funds to substitute for domestic resources, and not make enough effort to increase domestic revenues through taxation.

6. **Aid may not reach those most in need**
   - Donors do not allocate aid resources on the basis of the greatest need for poverty alleviation, but focusing on promoting their own interests.
   - Recipient country governments may not be genuinely committed to poverty alleviation or lack the necessary expertise to design and implement poverty alleviation policies
   - Tied aid may favor projects that are not appropriate for poverty alleviation.
   - Donors may select projects that are not the most effective from the point view of poverty alleviation.



Evaluating ODA Disadvantages

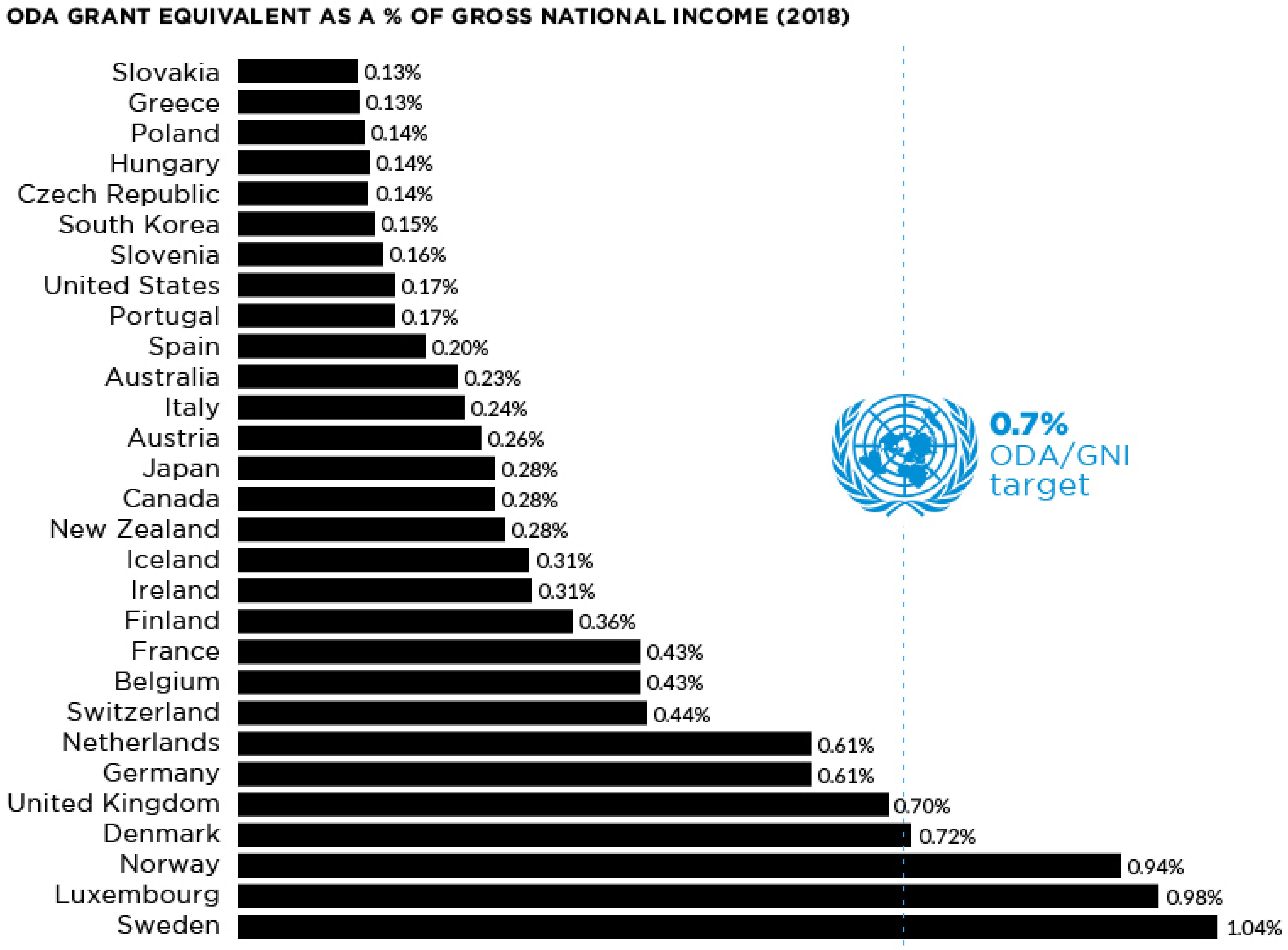
7. Aid may be associated with corruption

- Misuse of aid funds by recipient countries.
- Corruption tends to be more prominent the lower the per capita income of a country.

8. The quantity of aid and poverty alleviation

- SDG 17.1 “Developed countries to implement fully their official development assistance commitments, including the commitment by many developed countries to achieve the target of 0.7% of ODA/GNI to developing countries…”
- Many developed countries failed to do so.

→ The overall ODA funds are far less than the target amount → developing countries will be unable to make the necessary investment to improve welfare and support the economy on the scale required to achieve the SDGs.



Evaluating NGOs
Advantages

1. **Strong anti-poverty orientation of activities**
   - NGO activities are for the most part concerned with reaching poor people and helping them emerge from their poverty.
2. **Working closely with project beneficiaries.**
   - NGOs work closely with their beneficiaries, involving local people in the design and implementation of development projects.
   - Involving local people:
     - Deciding what problems should be addressed and how they should be solved
     - Give local people a sense of ownership and commitment to the project, contributing greatly to success.
3. **Contributing to democratization, advocacy and raising public awareness and support.**
   - The participatory practice mentioned in last point contribute to a process of democratization.
   - NGOs play an important leadership role in acting as advocates on public policy issues, and ensuring that poor people's concerns are heard.

Evaluating NGOs
Advantages

4. Offering expertise and advice

- International NGOs accumulate experiences, many of which may be relevant and transferable to similar settings in other countries
- NGOs recruit experts in various areas with strong commitment to the objectives of the NGO.

5. Ability to be innovative in pursuit of solutions.

- Unlike governments with uniform approach to problems, NGOs can be more creative and innovative in devising solutions to very specific problems that arise in local setting.
- NGOs enjoy more freedom because their activities are not subject to the conditions imposed by donors of aid (conditionality) or subject to the restrictions associated with tied aid.

6. Enjoying the trust of beneficiaries

- NGOs enjoy greater trust than governments due to their close relationship with project beneficiaries and their commitment to solving problems at grassroots level.

Evaluating NGOs
Disadvantages

1. **Small size and weakness of many NGOs**
   - Small NGOs with limited resources and lack of skilled personnel → limited effectiveness of their projects.
2. **Possible loss of independence due to growing dependence on governments and aid agencies for funding**
   - As NGO become more dependent on their outside sources (government, aid agencies, bilateral and multilateral donors) for their funding, they may lose their independence if they are forced to conform to the demands of funders.
3. **NGOs may attract the best qualified personnel away from government**
   - NGOs demand for technical experts and personnel may deprive governments of scarce highly qualified personnel with higher salaries and benefits.

Evaluating NGOs
Disadvantages

4. Challenge to state authority

- Host country governments often dislike the advocacy role taken on by many NGOs, which may conflict with government policy or question its authority.
- NGOs need to form a good partnership with the government, not to be a replacement of government.

Debt relief

- *SDG 17.4 "assist developing countries in attaining long-term debt sustainability through coordinated policies aimed at fostering debt financing, debt relief and debt restructuring'.*

- **Actions:**
  - **Debt restructuring** – new loans by commercial banks on better terms (longer periods at lower interest rates) to pay off some of the old loans.
  - IMF and The World Bank gave **conditional loans** to cover large and growing current account deficits, it require the borrowing country government to pursue policies prescribed by the IMF, including:
    - Tight fiscal and monetary policies
    - Liberalization policies and market-based supply-size policies
  - **Heavily Indebted Poor Countries (HIPC) Initiative** – provide debt relief. To qualify for debt cancellation, countries must:
    - Have a per capita GNI below a particular level
    - Have a debt level that cannot be sustained (in a debt trap)
    - Show evidence that they are following certain elements of IMF and World Bank policies
    - Commit themselves to pursuing a **poverty reduction strategy**.
      - Development of rural infrastructure
      - Providing health services and education
      - Creating new jobs
      - Providing family planning services

      → Ensure that more money is directed to the needs of the poor.

  * As of 2019, there were 39 countries eligible to receive HIPC assistance, of which 36 were full debt relief.

Debt relief

- **Limitations of Debt Relief:**
  - Some of the bilateral creditors have not provided any relief and the rate of delivery of funds remains low.
  - The program takes effect too slowly
  - Some measures that are imposed as conditions for a country to qualify are too severe.
    - Charging fees for schools and hospitals
    - Privatizing key public enterprises such as electricity and telephone
    - Reductions in government expenditures that reduce the provision of social services and infrastructure.
  - Some other countries that are highly indebted have not been included in HIPC Initiative. Those countries are not poor enough or indebted enough to qualify for assistance. Their debt situation is considered to be more manageable.

7. Multilateral development assistance

Multilateral development assistance

- **Multilateral development assistance** involves lending to developing countries on non-concessional terms, in other words with rates of interest and repayment periods determined in the market.

- **Major multilateral lenders**:
  - Multilateral development banks
    - World bank
    - African Development Bank
    - Asian Development Bank
    - Inter-American Development Bank
    - European Bank for Reconstruction and Development
  - The International Monetary Fund (IMF)

- **Mission**: lending for economic development or international financial stability. (not for commercial or profit reasons)

The World Bank

- The **World Bank** is a development assistance organization that extends long-term loans to developing country government for the purpose of promoting economic development and structural change.
  - *It was established in 1944, at the end of the Second World War, as part of an effort to help reconstruct Europe.*
  - *From late 1950s, its activities were extended to developing countries.*
- It is composed of 189 member states.

- 【科普】国际货币基金组织IMF与世界银行的区别_哔哩哔哩_bilibili

The World Bank

The importance of the World Bank as a development assistance organization lies mainly in its role as a lender of funds to governments.
(IBRD and IDA)

The International Bank for Reconstruction and Development (IBRD)

- It lends on non-concessional (commercial) terms to middle income developing countries. (not part of foreign aid)
- The greatest part of World Bank lending for development purposes (about 75%) is offered by the IBRD.

The International Development Association (IDA)

- Established in 1960
- It has similar activities to the IBRD but extends loans to low-income countries on highly concessional term.

- **International Finance Corporation (IFC)**
- **International Centre for Settlement of Investment Disputes (ICSID)**
- **Multilateral Investment Guarantee Agency (MIGA)**

Focus on private investments in developing countries

History of the World Bank

- Early years – lending for the development of infrastructure (energy, transport, telecommunication, irrigation, etc.)
- By the early 1970s – poverty alleviation in developing countries
  - Help the poorest 40% of developing country population
  - Focusing on water, supplies, sanitation, education, health, employment, etc.
- End of 1970s - early 1980s
  - Structural adjustment loans (SALs) –reducing government intervention, promoting competition
  - Loans provided in areas of:
    - Removal of price controls
    - Interest rate liberalization (freeing up of interest rates)
    - Trade liberalization (eliminate/lower barriers to trade)
    - Elimination of restrictions to new FDI by multinational corporations
    - Privatization
    - Deregulation
    - Cut in government spending
- By the 1990s – SALs has been criticized by its negative consequences on developing country economies

Current activities of World Bank

- Since the mid-1990s, The World Bank focused on:
  - poverty alleviation
    - →The Millennium Development Goals
    - →The Sustainable Development Goals (environmental sustainable)
  - It changed the views on the appropriate role of government in economic growth and development. Government intervention plays important roles in poverty alleviation. (ignored by SALs in past years)
  - It pays more attention to the need for institutional development. Markets need institutions to:
    - Provide education and health care services
    - Ensure availability of and access to necessary infrastructure
    - Provide an effective and equitable taxation system
    - Ensure access to credit by all who needs it
    - Secure property and land rights
    - Minimize the possibilities for the excise of corruption
    - Empower women and other disadvantaged groups
    - Promote appropriate technology development and innovation
    - Give a political voice to the economically weak
    - Ensure and promote competition

Evaluating the role of the World Bank

- **Social and environmental concerns**
  - It has been criticized for implementing socially unsound projects and environmentally unsustainable projects.
  - Improvement: it makes more efforts to ensure that project objectives are consistent with the SDGs.
- **World Bank governance dominated by rich countries**
  - Voting power in its governance is determined by the size of financial contributions made by each countries to the organization. → greater power of rich countries
  - Decisions are made without regard for the need and wishes of developing countries.
- **Excessive interference in countries' domestic affairs**
  - World Bank interferes excessively in the domestic policy affairs of developing countries.

Evaluating the role of the World Bank

- **Conditional assistance (lending)**
  - Imposition of conditions that must be met by borrowing countries to qualify for a loan.
  - It deprives countries of control over their domestic economic activities
- **Inadequate attention to poverty alleviation**
  - It has not doing enough to meet the challenges of extreme poverty in developing countries by not allocating enough funds for loans intended to meet the needed investment in education, health services and infrastructure.
  - It has not doing enough in the area of debt relief through the HIPC Initiative.
- **Excessive focus on market-based supply-side policies**
  - Focusing excessively on increasing flexibility in labor markets.
  - Encourage land grabs through privatizations and land takeovers that displace poor farmers.

The International Monetary Fund

The International Monetary Fund is a multilateral financial institution that was established jointly with the World Bank in 1944 with the original purpose of **lending to countries experiencing balance of payment deficits** under the system of fixed exchange rate that existed at the time.

- It is composed of 189 member countries.
- Its **Purpose** is to oversee the global financial system, follow the macroeconomic policies of its member countries, stabilize exchange rates and help countries that experience difficulties making their international payments by extending them short-term loans on commercial terms.

The history of International Monetary Fund

- In 1940s - 1960s, more than half of its lending was to developed countries.
- In 1970s and 1980s, many poor oil-importing countries encountered serious balance of payments difficulties → shifting towards developing countries
- During 1990s, it expanded its lending to transition economies in central and eastern Europe and the former Soviet Union.
- Since 2008 financial crisis, its lending has increased significantly to countries around the world.

The stabilization policies of International Monetary Fund

Stabilization policies – The loans provided by the IMF usually come with a package of policies that the country must adopt as a condition for receiving the loan.

- **Contractionary monetary policy** (increasing interest rates →lower AD→ lower demand for imports & encourage inflows of financial capital →resolve BOP position)
- **Contractionary fiscal policy** (cuts in government spending/increases in taxation → lower AD & the level of economic activity)
- **Currency devaluation or depreciation** (discourage imports, encourage exports → resolve BOP position)
- **Cuts in real wages** → lower cost of production
- **Liberalization policies** (eliminating/reducing controls on prices, interest rates, imports and foreign exchange →promote a free market and free trade environment)

Evaluating the role of the IMF

1. **IMF governance dominated by rich countries (same with the World Bank)**
   - The IMF Voting power in its governance is in proportion to the size of each economy, giving rich countries far greater power in decision-making.
2. **Excessive interference in countries' domestic affairs**
   - Even more than in the case of World Bank, mainly due to its stabilization policies.
3. **Conditional lending (conditionality)**
   - Countries have been forced to accept harsh conditions running counter to their growth and development objectives.

Evaluating the role of the IMF

4. Damaging effects on developing countries.

- Stabilization policies' negative consequences:
  - Cuts in real wages where wage are low to begin with
  - Cuts in government spending on merit goods and food subsidies (necessities)
  - Imposition of fees for schooling and health care services among people who cannot afford them
  - Liberalization policies

→Increase in poverty and worsen income distribution (inequality)

→Lowering economic growth
→Creating a recession with increasing unemployment and increasing levels of poverty
→Inconsistent with economic growth and development objectives, with huge human costs

5. IMF stabilization policies based on a flawed concept

- In many developing countries tried the IMF program suffer not only increasing poverty but also low or negative rates of growth → unable to solve their BOP and external debt difficulties.

Institutional Change

Institutional Change

SDG 16 "Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels."

- Microfinance
- Mobile banking
- Women's empowerment
- Reducing corruption
- Property rights and land rights

Microfinance

Microfinance (microcredit), refers to credit (loans) in **small amounts** to people (or 'micro-enterprises' – business with small size) who do not ordinarily have access to credit.

- Delivered to poor people through **microfinance institutions (MFIs)**, including:
  - Credit unions
  - Financial non-governmental organizations (NGOs)
  - Informal savings and loan groups
  - Special programs for the poor provided by some commercial banks

- **Lending to:**
  - Micro-enterprises (street vendors, carpenters, seamstresses and so on, most of whom are in the informal economy.)
  - Landless rural workers
  - Small farmers
  - female heads of households
  - Pensioners
  - Displaced persons.

Advantages of Microfinance

- Positive impact on poverty reduction
- Higher incomes and more stable incomes
- Improvements in health, nutrition
- Higher primary school attendance
- Improvement in social and economic status of women.

Disadvantages of Microfinance

- **Microcredit schemes are not enough therefore they reach only a very small proportion of poor people.**

- **Microcredit schemes may become a substitute for urgent needed government anti-poverty policies.**
  - It's the responsibility of the government (public sector) to combat poverty. Such as provision of merit goods, including education, health care services and infrastructure.
  - Government must provide protection for physically or mentally disable people, displaced people or people in other vulnerable groups (not appropriate clients for micro-credit)

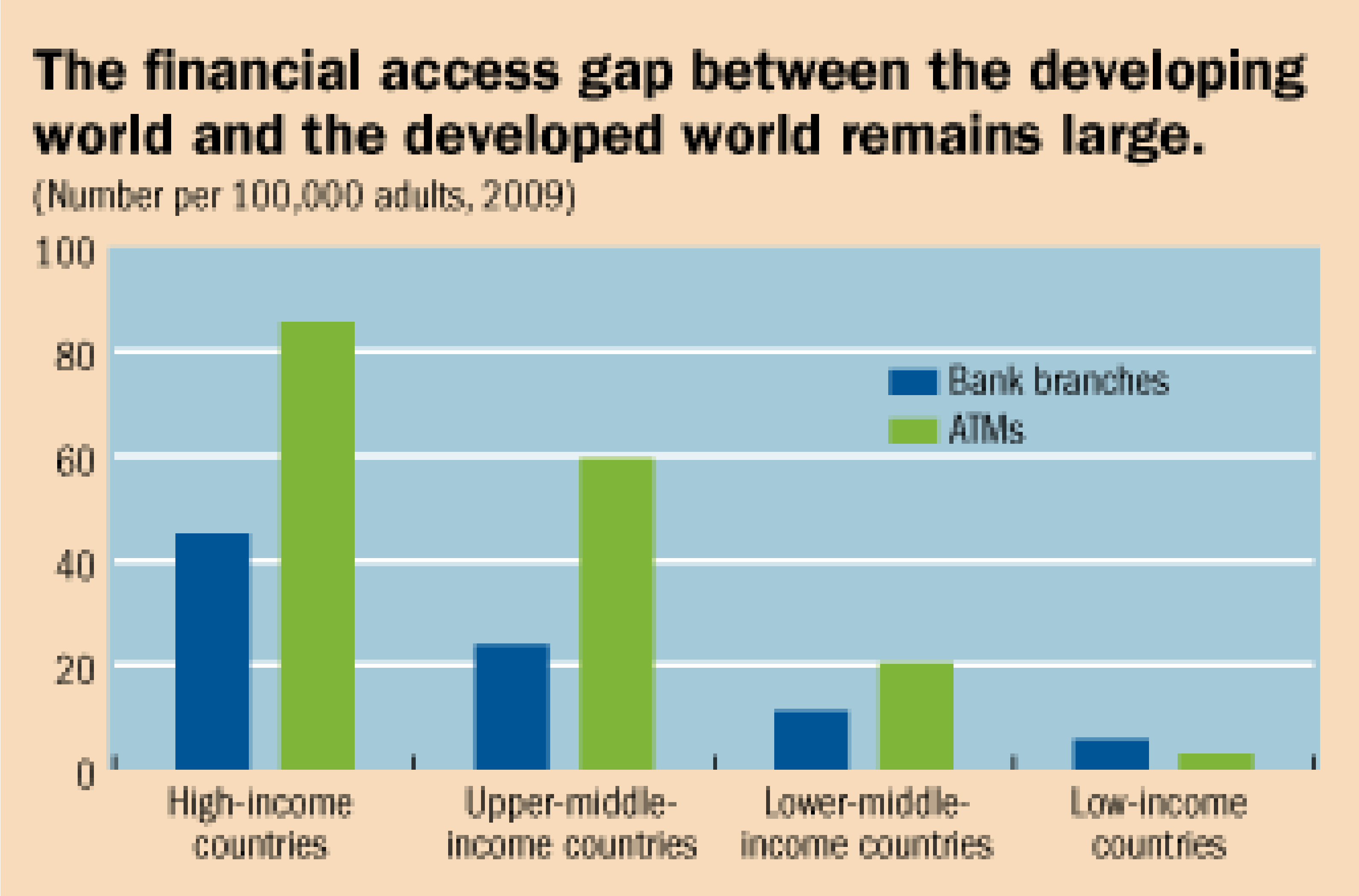
- **Microcredit schemes contribute to the growth of the informal economy.**
  - Microcredit encourages the growth of the controversial informal economy, which is unregulated, where workers have no social protection, and where exploitative conditions often prevail.

Disadvantages of Microfinance

- **Some extremely poor and highly unskilled people may be harmed by micro credit.**
  - Some extremely poor people may lack the necessary skills to begin a micro-enterprise. (such as basic literacy and numeracy skills) → burden those people to produce a stable source of income.
  - Solution: some microcredit program integrate credit with the provision of education.
- **Interest rates in micro credit schemes are too high.**
  - Interest rates for microcredit are often higher than market rates of interests. (lower than informal credit markets) - due to higher risk and cost
  - Possible solution: provide subsidized interest rates for the poorest borrowers.

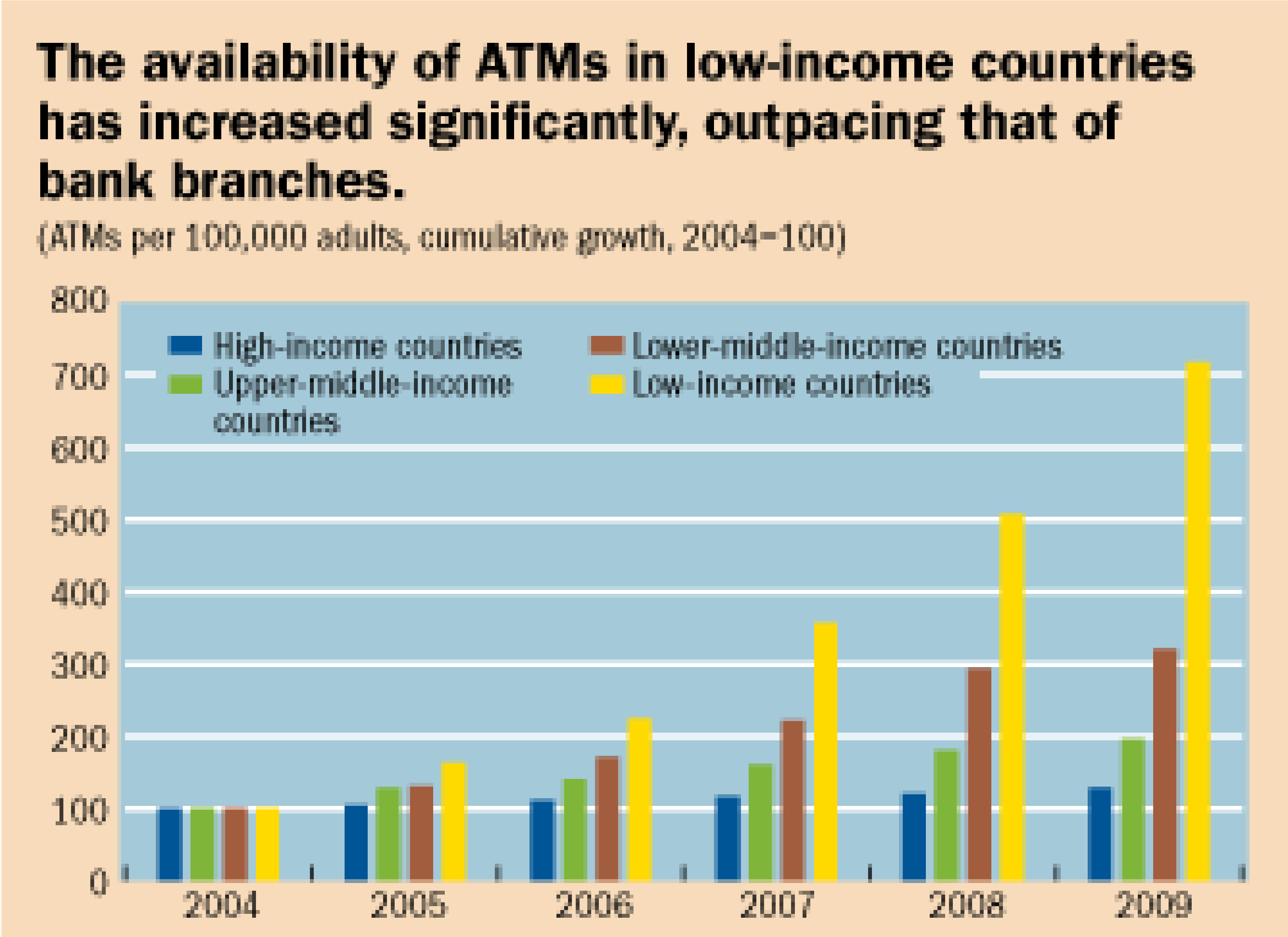
Mobile Banking

- **Mobile banking** involves the use of mobile telephones to receive or send money and to pay bills.



- Globally, 53% of adults do not have access to formal financial services
  - 80% in sub-Saharan Africa
  - 65% in Latin America
  - 68% in the Middle East
  - 59 in East and Southeast Asia
  - 58% in South Asia

  - 8% in high income OECD countries



Advantages offered by mobile banking

1. **Ease of making payments** to family and businesses with instant access and no delays in making or receiving payments.
2. **Avoidance** of having to **travel** long distance holding cash which may be stolen
3. **Reduced costs** of transferring money
4. Stronger links between relatives or businesses **in rural and urban areas**.
5. **Easier to pay workers** delivering aid to geographically remote areas
6. **Easier to get loans, insurance and other services** that facilitate opening a business.
7. Easier to stretch out payments for **purchases of equipment** needed for a business
8. **Helps women** expand their range of activities such as leaving subsistence farming and beginning small businesses
9. **Ease of buying inputs for businesses** without having to travel long distances to pay for them
10. Due to all of the above, it makes a major contribution toward **poverty reduction**.

Challenges of mobile banking

1. **Network problems**, causing delays
2. **Cost of the services** is high in relation to very low incomes especially in rural areas.
3. Inability of some **older people** to read, which makes them more **susceptible to fraud**.

Women's Empowerment

SDG 5 "Achieve gender equality and empower all women and girls"

➢ Women account for half the world's population; they represent 70% of the world's poor and earn 10% of the world's income.
  - Interlinked with 'The Gender Inequality Index (GII)' （CH18）

- **Positive externalities (external benefits) of women's empowerment**, it can be thought of as **consumption externalities** of women's health and education.
- The increased education of woman and increases in women's income levels will lead to:
  - Improvements in child health and nutrition and lower child mortality.
  - Improvements in educational attainment of children
  - Higher quality of human resources (as cumulative effects of the improved health and education of children) → contribute to economic growth and development, break out of the poverty cycle.
  - Lower fertility (lower birth rates) – due to later marriage and greater reproductive choice for women.

Women's Empowerment

Relevant policies to eliminate inequalities between women and men by The United Nations Population Fund (UNFPA):

- Establishing mechanisms for **equal participation and representation** by women in the **political process**
- **Promoting education, skill development and employment** while giving top priority to elimination of poverty, illiteracy and poor health
- Improving women's **ability to earn income beyond traditional occupations**, while ensuring **equal rights in the labour market**.
- **Eliminating violence** against women
- **Eliminating all discrimination** against women, including discriminatory practices by employers.
- Making it possible for women to **combine childbearing and child rearing with participation in the labour force**.

Reducing corruption

SDG 16.5 "Substantially reduce corruption and bribery in all their forms."

Recommended policies:

- Develop **high levels of transparency and independent external scrutiny** which allows audit agencies and the public to provide supervision.
- Reform institutions of **tax administration**.
- Build a **professional civil service**, based on transparent, merit-based hiring and pay.
- **Focus on** areas where there is a **higher risk of corruption**, such as procurement, revenue administration and natural resource management.
- Cooperate with other countries to **make it more difficult for corruption** to take place across borders.

Reducing corruption

Actions of the World Bank:

- Establishing **institutions and incentives** to prevent corruption from occurring.
- Create mechanisms that discourage corruption by providing **penalties and sanctions**.
- Influencing the development of **perceptions of the type of governance needed** for long term efforts to fight corruption.

Property Rights and Land Rights

SDG1.4.2 "Proportion of total adult population with secure tenure rights to land, with legally recognized documentation and who perceive their rights to land as secure, by sex and by type of tenure."

→ It is a measure of **equal rights to economic resources**, particularly **by the poor and vulnerable**.

→ Important for growth as it encourages investment and facilitates credit that allows investment to increase.

The establishment of property rights takes the form of **titling to property**.

- Secure land rights:
  - Contribute to food security as they improve sustainable land use, improve access to credit, and increase productivity of small farmers.
  - Lead to lower rates of deforestation.
  - Preserve diverse food cultures and biodiversity
  - Support indigenous peoples and improve their economic and social status
  - Contribute to gender equality when granted to women
  - Contribute to poverty reduction
- It can be problematic in developing countries particularly in connection with land, it cannot provide legal protection for land based on custom or communal use.

Property Rights and Land Rights

To ensure property and land security:

- **Good system of recording**, maintaining and publicizing tenure rights and responsibilities, including who holds the rights to land, fisheries or forests. It can record individual and collective tenure rights of the state and public sector, the private sector, indigenous people and other communities.
- There should be **anti-eviction legislation**, along with access to **legal advisors** so that formally recognized rights of poor farmers are supported.
- Government should consider **agrarian reforms** aiming to redistribute land to ensure more equitable access.

Summary of Market-oriented policies

Market-oriented policies include:

- Market-based supply-side policies
  - Policies encouraging competition (deregulation, privatization and anti-monopoly regulation)
  - Labour market reforms
  - Incentive-related policies (adjustments to various types of taxes)
- Trade liberalization
- Freely floating exchange rates

Evaluating market-oriented policies

Strengths

1. **Policies encourage competition** result in greater efficiency in production, lower prices and improved quality and a better allocation of resources.
   → economic growth and improved economic well-being.

2. **Labour market reform** promote free market forces in labour markets
   → better allocation of labour resources.

3. **Incentive-related policies** improve the incentives to work, innovate and invest → making the signaling and incentive functions of the price mechanism more effective →improve the allocation of resources → economic growth

Evaluating market-oriented policies

Strengths

4. **Trade liberalization** make markets much larger than they would be with trade barriers → increasing competition, increasing efficiency in production, lower prices and improve quality, increase consumer choice, improve the allocation of resources and greater economic growth.

5. **Freely floating exchange rate**: market-determined exchange rate reflects the forces of supply and demand for a currency, and therefore can effectively carry out the signaling and incentive function of price (of a currency) for international transactions of all kinds.
   →Bringing a balance in the balance of payment
   →Greater flexibility to policy makers to pursue policies needed domestically.

Evaluating market-oriented policies

Weaknesses

1. **Market-oriented strategies cannot deal with Market failure of:**
   - Common pool resources and negative environmental externalities (of production and consumption)
   - Insufficient provision of merit goods
   - Failure to provide public goods
   - ➢ Especially important in many developing countries.

2. **Weak institutional framework**. Developing countries need:
   - A stronger legal system with enforcement of legal contracts and effective legal resource
   - A more effective taxation system
   - A better-developed banking system
   - A more effective system of property and land rights
   - Good governance.
   - ➢ Market-oriented policies cannot improve institutions.

Evaluating market-oriented policies

Weaknesses

3. Insufficient credit for poor people

- The market does not allow poor people with no collateral and seeking very small loans to acquire the credit they need. This results in:
  - Lower investment possibilities
  - Greater poverty and poorer income distribution
  - Inability to escape the poverty cycle.

4. Income inequalities and poverty

- Labour-market reform → loss of protection of workers
- Policies to encourage competition, trade liberalization → closure of some firms → increase in unemployment →increase in income inequalities and greater poverty.
- The inability of certain groups of people to take advantage of opportunities opened by trade and market liberalization → increase in income inequalities.

5. Inability to alleviate poverty

- Poverty alleviation policies (such as change in taxation, transfer payments, the imposition of minimum wages and increased provision of merit goods) cannot be carried out by market-oriented policies.
- Market-oriented policies cannot help people or communities break out of the poverty cycle.

Evaluating market-oriented policies

Weaknesses

6. **Inability to empower women**
   - Empowerment of women requires provision of merit goods as well as legislation that only governments can undertake.

7. **Informal economy**
   - Market-oriented policies may lead to the growth of the informal economy as workers lose their jobs in the formal economy.

8. **Questionable effects on economic growth and development**
   - Only countries already developed an industrial base can take advantage of opportunities offered by trade and market liberalization.
   - Low-income countries with weak industrial base often experience weakening of their industry together with increased unemployment, poverty and growth of the informal economy.
   - The withdrawal of government from provision of merit goods → negative effects on economic and human development.

Summary of Interventionist policies

4.1 Redistribution policies

- Tax policies
- Transfer payments
- Minimum wages

4.2 Provision of merit goods

- Education and health services
- Infrastructure

Evaluating interventionist policies

Strengths

Interventionist policies are based on government intervention in markets intended to correct market deficiencies and create an environment in which markets can work more effectively.

1. **Correcting market failures** by policies to:
   - Correct negative environmental externalities of production and consumption
   - Resolve overuse of common pool resources
   - Provide public goods as well as merit goods.

2. **Investment in human capital** (education and health)
   - Education and health are major factors behind increases in productivity that contribute to greater economic growth, and directly lead to greater economic and human development.
   - Investment in human capital also forms a part of industrial policies.

Evaluating interventionist policies

Strengths

3. Provision of infrastructure

- Correct market failure of positive externalities
- Increase productivity and improve standards of living
- Encouraging economic growth as well as economic and human development.

4. Development of stronger institutions

- Government build institutions that enable markets to operate more effectively, including legal, taxation, banking and property and land rights systems.

5. Redistributing income and reducing poverty

- By tax policies, transfer payments and minimum wages

Evaluating interventionist policies

Strengths

6. Promotion of gender equality

- Government pursue policies that promote women's empowerment and gender equality in education and health, the labour market, inheritance and property rights, and access to credit.

7. Industrial policies (interventionist supply-side policies)

- Support for small- and medium- sized businesses as well as protection of infant industries
- Support of appropriate technology transfer from developed countries
- Establishment of a research and development capability

→ help developing countries in the early stages of their industrialization.

→ help developing countries diversify into higher value-added activities

8. Provision of a stable macroeconomic environment

- Government policies to reach a stable macroeconomic environment, including price stability, full employment, a reasonable budget deficit and a reasonable balance of trade.
- Ensuring economic decision-makers can plan their future economic activities.

Evaluating interventionist policies

Weaknesses

1. **Need for budget funds: opportunity costs and budget deficits and debt**
   - Weak taxation collection and low income of taxpayers in developing countries →insufficient budget funds
   - Opportunity costs
   - Risks of increasing budget deficits and debt.

2. **Excessive bureaucracy and inefficiency**
   - Too many rules governing procedures, red-tape, unproductive workers, high administrative costs and inefficiency

3. **Possible protection of inefficient producers**
   - Policies like trade protection, price floors, subsidies may lead to protection of inefficient producers. → inefficiencies and a waste of resources in the private sector.

Evaluating interventionist policies

Weaknesses

4. **Excessive intervention leads to allocative inefficiencies**
   - In the forms of too many industrial policies, too much intervention in the foreign exchange market, too much trade protection.

5. **Possible influence of elite groups exerting political pressures**
   - Elite groups with too much power over politicians, favoring policies in their own interests rather than the interests of society.

6. **Corruption**
   - In Countries where legal system, mass media and the system of public administration are weak, the government may be susceptible to corruption.

7. **Poor governance**
   - Poor governance referring to the process of designing and implementing policies within a government,
   - Interventionist policies may not be carried out effectively.