Trade strategies: liberalisation and integration

Activity

As you read this and the following sections, continue working on the mind map you started in subtopic 4.9 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30278/). In this section, you will build on it with growth and development strategies that address those barriers.

This way you can clearly link strategies with barriers, where there is a connection. It should also help you to visualise the tangled wicked problem of development economics.

As you learned in section 4.9.4 (/study/app/pp/sid-186-cid-754025/book/economic-barriers-international-market-access-id-30592/), trade tends to be a disproportionately large factor in developing countries' economic activity. Trade is not an end itself. Rather, it is a strategy to promote economic growth and development.

We need to be aware that trade policies can have both positive and negative impacts on a country and its population. Imports may lower prices for a diffuse group of consumers, but they may also result in the loss of jobs and income for another concentrated group of workers. Therefore, all countries must consider and mitigate these win–loss dynamics among stakeholders and economic sectors to avoid increasing inequality and to ensure that growth and development is inclusive.

There are strengths and limitations of the various trade policies that countries adopt. The ideas explored below are similar to those you already explored in subtopic 4.1 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30650/) and subtopic 4.3 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30680/), but with a specific focus on low-income countries.

Figure 1. A container ship at the Port of Dakar, Senegal.

Credit: Getty Images HendrikDB

Overview (/study/ap 186- cid- 754025/

Strengths of trade liberalisation / economic integration / bilateral and regional trade agreements

Trade liberalisation is when countries remove barriers to trade such as subsidies, tariffs, quotas and administrative barriers. Economic integration is the process by which countries coordinate and link their economic policies, which usually involves trade liberalisation as a first step. This trade liberalisation may come through WTO agreements, or it may come from regional or bilateral trade agreements. All of these topics were discussed in subtopic 4.1 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30650/) and subtopic 4.4 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30657/).

An important example of trade liberalisation/economic integration/regional trade agreements in action in developing countries is the recent Africa Continental Free Trade Area (AfCFTA). The goal of this trade agreement is to develop a single market for goods and services among 54 countries in Africa. The AfCFTA will see the free movement of business travellers and investments, and aims to create a continental customs union to harmonise trade relations with external countries. The tariff-free movement of goods is expected to increase trade within the market, affecting 1.2 billion people with a combined GDP of USD 2.5 trillion. It will also give landlocked countries easier and cheaper access to ports for export (see section 4.9.6 (/study/app/pp/sid-186-cid-754025/book/geographic-barriers-landlocked-id-30585/)). The video below outlines the agreement and its benefits.

Student view

To further explain how the AfCFTA should affect markets, consider the hypothetical case of the market for cement in Benin in **Figure 2** below.

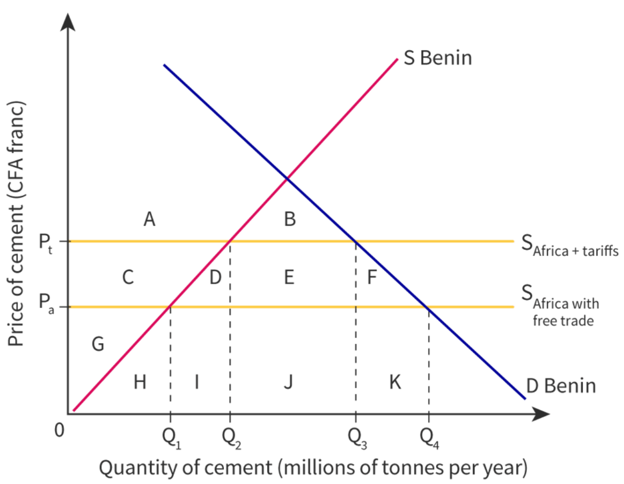

Figure 2. Impact of eliminating tariffs on the market for cement in Benin

More information for figure 2

The graph illustrates the supply and demand for cement in Benin, showing the impact of eliminating tariffs. The X-axis represents the quantity of cement in millions of tonnes per year, marked with points Q1, Q2, Q3, and Q4. The Y-axis represents the price of cement in CFA francs, indicated by points Pt and Pa.

Two supply curves are present: 'S Benin,' representing local supply, and 'S Africa with free trade,' indicating supply under free trade conditions. The original supply with tariffs is labeled 'S Africa + tariffs.'

Eliminating tariffs reduces the price of cement from Pt to Pa. The supply shifts from 'S Africa + tariffs' to 'S Africa with free trade,' resulting in increased import quantities from Q3-Q2 to Q4-Q1. This also increases the total quantity of cement in the market from Q3 to Q4.

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The elimination of tariffs among countries in the AfCFTA will cause the price of cement in Benin to decline from P_t to P_a. As a result, the total quantity of cement, a resource used in most building and infrastructure projects, will increase from Q_3 to Q_4. The quantity of cement imported into Benin will increase from $Q_3 - Q_2$ to $Q_4 - Q_1$. The quality of this cement may be better or different to that which is already produced in Benin. The benefits for Benin's economy can be seen in **Table 1** below.

The extent of the benefits of trade liberalisation depend on whether trading partners are also liberalising their trade policies. If trading partners are also lowering trade barriers, as they should be under regional or WTO trade agreements, then significant economic gains can be achieved in exports. In the case of the AfCFTA, countries across the African continent will lower barriers, so individual countries should achieve benefits from increased imports and exports, listed below in **Table 1**.

Exam tip

Students often forget to include diagrams in their longer exam responses on development topics, but these are critical to maximise your marks.

Remember when you are discussing the economic growth benefits of various strategies, you can use an AD/AS diagram to illustrate your points, identifying factors affecting aggregate demand or aggregate supply related to the strategy.

When you are discussing the material dimension of human development strategies you can use a poverty trap/cycle diagram, showing virtuous positive feedback loops.

Table 1. Benefits of trade liberalisation.

Benefits of increased imports	Benefits of increased exports
Increased competition from foreign firms should lower prices for consumers	Access to larger markets can increase the revenues and profits for firms
Increased competition from foreign firms should improve the quantity and quality of products for consumers	Exports bring income in hard currencies for low-income countries, which can be used to buy resources on global markets

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Benefits of increased imports	Benefits of increased exports
Increased competition from foreign firms and lower prices should pressure domestic firms to lower costs of production, improving productive efficiency	Access to larger markets should lead to larger production levels, which can result in economies of scale and lower costs of production for firms, improving productive efficiency and competitiveness on global markets
Consumers should have greater choice of products	Increased exports cause aggregate demand and national income to increase (ceteris paribus), increasing employment
The country can access natural resources and technologies that are not available in its own country	Domestic firms may be able to sell goods and services for higher prices abroad than they do in domestic markets, increasing revenues
Improved international cooperation	
More efficient global resource allocation	

Activity

To practise evaluating the benefits of trade liberalisation, consider the case of Benin and cement. Explain the advantages of trade liberalisation using the information in **Table 1** as a guide. You do not have to work with every benefit listed, but choose the ones that may be most relevant for cement in Benin.

Role of the WTO

You learned about the role of the World Trade Organization (WTO) in subtopic 4.4 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30657/), so we will not explore its overall functions in detail here. Here we will focus on the role of the WTO in promoting trade with low-income countries.

Over 75% of WTO members are classified as developing or least-developed countries. All WTO trade agreements have special provisions for the least-developed countries to help protect them from the downsides of free trade. These special provisions give low-income countries longer time periods to implement their commitments, and provide measures to increase their trading opportunities. The WTO also helps low-income countries build the infrastructure and institutions to participate in WTO negotiations, handle disputes and implement technical standards. There are some exemptions from requirements in trade agreements and they also allow certain forms of protectionism, such as some types of subsidies to promote infant industries and diversification.

Student view

The WTO also works on programmes for Aid for Trade. This offers financial help for low-income countries to participate more effectively in global trade. The WTO works to gather donors, development agencies, government and the private sector together to foster trade-related development programmes. Donor countries have committed an average of USD 40 billion per year for such programmes.

Finally, the WTO provides technological support to low-income countries to help them improve communications by providing computers and internet access to improve their network with the WTO, its databases and documentation. Not all countries are able to have permanent representatives to the WTO in Geneva, so these communication networks are important for them to access WTO resources.

International Mindedness

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The World Trade Organization agreements have a component called the most-favoured nation (MFN) clause. This requires countries in the WTO to treat all their trading partners the same, so that a beneficial trade arrangement with one (most-favoured) country is granted to all others.

However, SDG 17, Target 17.12 promotes tariff-free and quota-free access for developing countries to developed country markets. This means that high-income countries can eliminate trade barriers for the poorest countries, without having to do so for every other country in the world.

This is an example of how international cooperation can help boost the economic growth and development prospects of low-income countries by making concessions to the normal rules of WTO agreements.

Limitations of trade liberalisation / economic integration / bilateral and regional trade agreements

As you learned in subtopic 4.3 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30680/), there are a number of arguments against trade liberalisation which are relevant for developing and least-developed countries. Free trade can provide immense diffuse benefits to economies, but it also has downsides for particular stakeholders as well as for the diversification and balance of payments goals of low-income countries.

Some of these problems can be illustrated with the same tariff diagram we used for Benin and the cement industry in **Figure 2**. One problem is the impact on domestic cement producers of reducing tariffs. When tariffs were still in place, domestic producers sold their products at a price of P_t and quantity Q_2, resulting in a revenue of C + D + G + H + I. After tariffs are removed there is greater competition from foreign imports, so domestic producers now sell cement at a lower price of P_a and quantity Q_1, resulting in lower revenues G + H.

Student
view

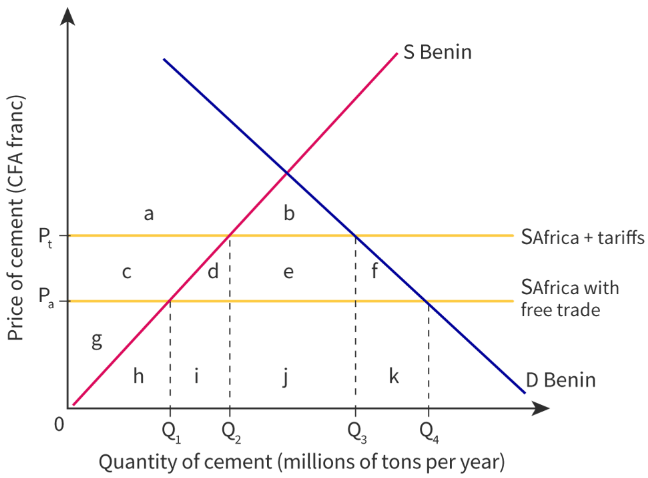

Figure 2. Impact of eliminating tariffs on the market for cement in Benin

More information for figure 2

This graph illustrates the impact of eliminating tariffs on the cement market in Benin. The Y-axis represents the price of cement in CFA francs, while the X-axis represents the quantity of cement in millions of tons per year. The graph shows multiple lines: the pink line represents Benin's supply of cement (S Benin), and the blue line represents the demand in Benin (D Benin). Two horizontal yellow lines represent South Africa's supply, one with tariffs (S Africa + tariffs) and one with free trade (S Africa with free trade).

The graph marks two key price points: Pt (price with tariffs) and Pa (price after tariffs are removed). Initially, with tariffs, the quantity of cement sold is at Q2, with domestic producers receiving revenue represented by areas C + D + G + H + I. After tariff removal, the price drops to Pa, and the quantity increases to Q1, reducing domestic revenue to areas G + H.

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Segments are labeled with letters a, b, c, d, e, f, g, h, i, j, k indicating different areas on the graph related to quantity and price shifts due to tariff changes.

[Generated by AI]

This may mean that some cement producers in Benin go out of business and their employees lose their jobs. Even if they survive, they may need to become more productively efficient, by reducing wages or firing workers. This may be damaging for cement workers, and those who depend on their income. As education and training opportunities in low-income countries may be limited, it can be hard for workers to find new employment opportunities, which will significantly harm their well-being.

Additionally, Benin will now be more reliant on foreign imports of cement, which is essential for building and infrastructure. This can make them more dependent on foreign countries, which can result in problems if there is any disruption to trade, such as during the COVID-19 pandemic, or if diplomatic relationships are damaged. Dumping may also occur, which will cause unfair and excessive damage to Benin's cement industry. Benin will also earn less revenue when the tariffs are eliminated. As you learned in section 4.9.9 (/study/app/pp/sid-186-cid-754025/book/institutional-barriers-tax-id-30594/), low-income countries rely disproportionately on tariffs for their tax revenues. Finally, free trade agreements may prevent Benin's government from protecting industries in the hope of diversification. **Table 2** below summarises the disadvantages or limitations of trade liberalisation, with a particular focus on how increased imports may undermine other government goals.

Table 2. Arguments against (limitations of) trade liberalisation

Key words	Explanation
national security	Free trade agreements may prevent governments from developing or protecting industries that may be vital to national security, such as steel production, concrete, or food.
infant (sunrise) industries / diversification	Free trade agreements may prevent governments from using trade barriers to develop and protect new industries (particularly in manufacturing) for the goal of diversification (see section 4.7.4 (/study/app/pp/sid-186-cid-754025/book/the-importance-of-resilience-and-id-30438/) and section 4.10.2 (/study/app/pp/sid-186-cid-754025/book/trade-strategies-alternatives-to-liberalisation-id-30681/)).
health, safety, environment	Free trade agreements may prevent governments from using trade barriers (particularly non-tariff barriers) to protect their populations and environment from damage from harmful imports.
anti-dumping / unfair competition	Free trade agreements may prevent governments from using trade barriers (particularly tariffs) to protect their industries from dumping and other forms of unfair competition from foreign firms.
balance of payments	Free trade agreements may prevent governments from using trade barriers to reduce imports in order to improve the balance of payments. HL students should be able to link back to subtopic 4.6 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30345/) on the implications of persistent balance of payments problems, which are an issue for many low-income countries.
government revenue	Free trade agreements may remove tariffs, which can be an important source of government revenue. Many low-income countries depend on tariff revenues because their ability to collect revenues from direct and indirect taxes on their low-income populations and informal markets is limited.
job protection	Free trade agreements may prevent governments from using trade barriers to protect industries that employ large numbers of people. Poverty reduction is very important for low-income countries, and education and retraining limited, so protectionism may be a valid reason to secure jobs.

Student view

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Key words	Explanation
dependence	Free trade agreements may result in a country becoming dependent on other countries for the imports of certain goods. If these imports become disrupted for any reason, the importing country could find itself without essential resources and goods.

In terms of the AfCFTA, there are critics of the agreement (https://qz.com/africa/1757394/africa-needs-to-industrialize-before-continental-free-trade-area/)who argue that it may hinder the ability of developing countries in the region to use a range of strategies to promote diversification and development of industry. In general, it is important to keep in mind that all countries' economies are extremely complex and advocating one set of strategies, such as trade liberalisation, cannot possibly meet all their diverse goals or particular circumstances. This is why the WTO has taken a more nuanced approach to the issue of trade liberalisation, to allow the country-specific context to play a role in trade agreements.

Activity

In this section, you were reminded about some advantages/strengths and disadvantages/limitations of trade liberalisation. In the following section, you will learn about alternative trade strategies.

Making summary tables of key information is a good study method. Create a summary table for all the trade strategies listed in this section and the upcoming 4.10.2 (/study/app/pp/sid-186-cid-754025/book/trade-strategies-alternatives-to-liberalisation-id-30681/), with their strengths and limitations. You may need to revisit information from subtopics 4.1 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30650/) and 4.4 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30657/) to complete the table.

Trade strategy	Strengths	Limitations
Trade liberalisation		
WTO*		
Bilateral/regional trade agreements*		
Import substitution		
Export promotion		
Diversification		

Student view Section Feedback

*Keep in mind that the main purpose of the WTO and bilateral/regional trade agreements is trade liberalisation, so many of the strengths and limitations will be the same. However, you can speak specifically about trade liberalisation in the context of working through the WTO or through agreements with smaller numbers of countries.

Complete section with 3 questions

Start questions

Previous section(/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30433/) Next section (/study/app/pp/sid-186-cid-754025/book/trad

Trade strategies: alternatives to liberalisation

Import substitution

Import substitution refers to protectionist measures that are implemented to help a country become independent from imports from abroad. To support domestic industry in its development, protectionism is used to limit foreign competition. This allows domestic firms to raise prices (or lower production costs in the case of subsidies) and to increase output. Infant (sunrise) industries may be supported as well. In the longer term, this should improve firms' competitiveness domestically and, eventually, abroad. Promoting independence and diversification may require protectionism in the short run. The policy of import substitution is illustrated in **Figure 1** below.

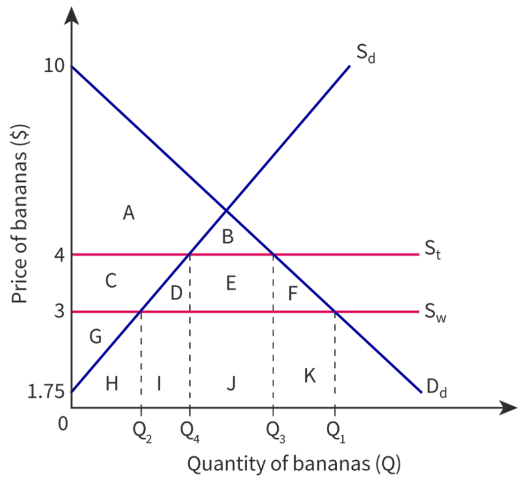

Figure 1. Protectionism in the form of tariffs is a form of import substitution.

More information for figure 1

The graph illustrates the effect of import substitution through tariffs on the banana market. The X-axis represents the quantity of bananas (Q), ranging from 0 to Q1, while the Y-axis represents the price of bananas in dollars ($), ranging from 0 to 10. The intersection of the original supply curve Sw and the demand curve Dd occurs at price USD 3 and quantity Q1. After the tariff, the new supply line is St, increasing the price of bananas to USD 4 and reducing world supply from Sw to St. As a result, the quantity of banana imports decreases from Q1-Q2 to Q3-Q4. The diagram includes several areas labeled A, B, C, D, E, F, G, H, I, and J that represent different sections of loss or gain in producer and consumer surplus. Domestic producers increase supply, benefiting from higher prices, raising revenue from areas G + H to G + H + C + D + I.

[Generated by AI]

In **Figure 1**, we can see that imposing an import tariff reduces world supply from S_w to S_{tw}, increasing the price of bananas from USD 3 to USD 4. As a result the quantity of banana imports declines from Q_1–Q_2 to Q_3–Q_4. The quantity of bananas supplied by domestic producers increases from Q_2 to Q_4. Domestic producers are now able to produce more at a higher price, increasing revenues from G + H to G+H+C+D+I. The domestic economy has substituted its own domestic production of bananas for some of the imports. This is known as import substitution.

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If import substitution results in increased domestic production and employment, economic growth should increase, ceteris paribus. Both domestic investment and consumption should rise and imports decline, causing aggregate demand and real GDP to increase. To the extent that rising incomes enable people to purchase goods and services that increase their standard of living, the material dimension of development should improve.

The arguments against this type of trade strategy are the same ones that we learned in subtopic 4.1.3 (/study/app/pp/sid-186-cid-754025/book/absolute-and-comparative-advantage-hl-id-30653/). Protectionism results in more inefficient domestic production. It reduces the gains from absolute and comparative advantage (subtopic 4.1.3 (/study/app/pp/sid-186-cid-754025/book/absolute-and-comparative-advantage-hl-id-30653/)). Returning to **Figure 1**, we can see the inefficiency in triangles D and F. The question is whether the gains to domestic producers justify this inefficiency. It is also important to keep in mind that this policy can only ever be partially successful in achieving its aims. Countries will find that they need to import essential raw materials and perhaps other manufactured goods if their physical and human capital resources do not produce all the things they need. Import substitution strategies may also damage relationships with other countries, resulting in greater diplomatic isolation.

Some Latin American countries benefited from import substitution in the 1930s. Their protection of key industries such as steel were seen as a road to progress and modernisation. Some leaders of Latin American countries saw the Soviet example as an inspiration for their decision, as well as it being a pragmatic response to the economic difficulties of that period. Mexico, Brazil and Argentina had particular success with these policies, because their large populations had sufficient income to support domestic production. By the 1960s, more than 90% of all goods consumed in Brazil and Mexico were produced domestically. Ecuador is a country that has more recently used import substitution to protect some industries.

Despite some successes of import substitution, the result in many cases was increased poverty as the means of production were monopolised by a few firms and the gains failed to be transferred across different income groups. In addition, there was a lack of competitiveness and efficiency among Latin American countries. Large current account deficits (due to heavy importing of raw materials , capital and intermediate goods) were financed by large amounts of external debt (http://www.earth.columbia.edu/sitefiles/file/about/director/pubs/BPEA1985_2.pdf). When interest rates rose this led to an international debt crisis in the 1980s. Import substitution did not reduce Latin American countries' reliance on other countries, it only changed the structure of it.

Student view

Export promotion

Export promotion, or export-led growth strategy, is any policy that supports domestic industries so that they become exporting industries. Like import substitution, trade protectionism is used to achieve this. However, the goal of import substitution is to reduce reliance on foreign imports, whereas the goal of export promotion is to transform production to be export-orientated.

Be aware

Import substitution and export promotion can be easily confused.

Import substitution and export promotion both use protectionism. However, the goal of import substitution is to reduce imports, whereas the goal of export promotion is to develop industries that can export globally.

A useful growth strategy is for governments to target specific export industries to develop specialised production. Selecting a few industries which can compete globally can create a positive trade balance and contribute to aggregate demand growth in the country. This can be done using subsidies, grants, funding for research and development and

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deregulation of certain industries, among other policies. Such measures can increase both the short-run and long-run aggregate supply, increasing actual and potential economic growth.

Export promotion was adopted by the four Asian Tigers (Hong Kong, Singapore, South Korea and Taiwan) during the second half of the 20th century. Together with a few other East Asian countries, they posted some of the highest growth rates and most successful poverty reduction the world had ever seen in developing countries. This greatly improved the material dimension of development in these countries.

Export promotion may require some trade liberalisation in order to participate in international trade agreements that lower barriers for a country's exports. However, it also involves choosing a specialised sector of the economy to promote externally (one that would become a niche market). As far as the trade agreements allow, some trade protectionism may be continued. Countries may even push the boundaries of those agreements with export promotion.

Figure 2. Hong Kong is often cited as an example of successful export promotion.

Credit: Getty Images amnad

Student view

The extent to which the Asian Tigers adopted free trade as a part of their export promotion policies is heavily debated. In the early 1990s, the World Bank declared in a research paper that these countries were an example of how free trade and free-market ideology can lead to growth and development for a country. In reality, these countries combined their free trade approach with some strong policies to support industry. They believed that to become globally competitive in an industry in the first place, some protection and government support may be necessary. Many countries in the region placed limits on capital flows. The governments of these Asian Tigers have become known over time for their strong interventionist approach .

While this interventionist approach has been cited for its success, critics have pointed out that a strong export orientation can make a country more susceptible to external shocks . This was seen in the Asian financial crisis in 1997. Additionally, it relies on good judgement and policy making to ensure that appropriate sectors are identified for support.

Diversification and resilience

According to UNCTAD (https://unctad.org/en/PublicationsLibrary/ser-rp-2018d2_en.pdf), over the past three decades low-income countries have liberalised and increased both imports and exports. This increased trade can bring many advantages. However, as you learned in section 4.9.3 (/study/app/pp/sid-186-cid-754025/book/economic-barriers-

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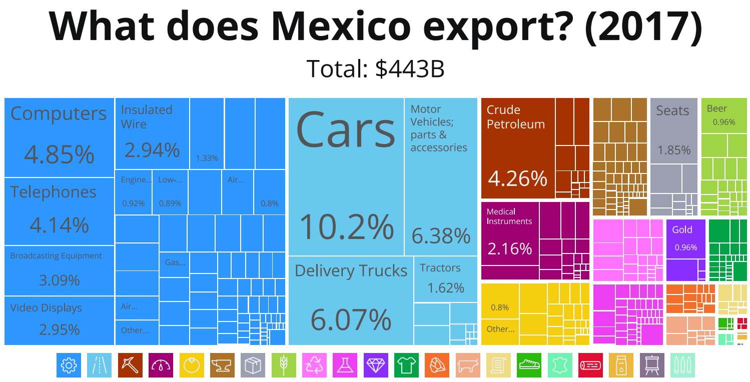
international-market-id-30583/), over-dependence on primary product extraction and export remains a problem. Most developing countries are aiming for greater diversification, which is the strategy of increasing the variety of goods and services that a country produces and exports.

One benefit of diversification is economic resilience. Resilient economies can bounce back from external shocks more easily. Just like biodiversity is important for the resilience of an ecosystem, productive diversity is important for the resilience of an economy. When one production or export area is negatively affected by external shocks, there are others that may not be affected and can continue to support the economy. Another benefit of diversification is that a varied economy can help channel revenues from resource-based sectors to other, perhaps higher-value-added sectors of the economy. This can make economic growth more inclusive and ensure longer-term prosperity and intergenerational equity . Third, export diversification can help smooth fluctuations in foreign exchange earnings, which can be more volatile when the economy is specialised, especially in primary products.

Important

Diversification is extremely important for a country's economic resilience. This economic goal often conflicts with goals of efficiency, which often requires that countries specialise to increase productivity and achieve economies of scale.

The increase in trade over the last 30 years has not led to diversification for all developing countries. In particular, UNCTAD notes that diversification has not improved for many countries in sub-Saharan Africa, in contrast to emerging economies in Asia and Latin America where export diversification has increased over time. We can see an example of this difference in the export mix of two countries with similar GDP per capita levels, Gabon (less diversified) and Mexico (more diversified) in **Figure 3**. Furthermore, UNCTAD notes that among some of the least developed countries, deindustrialisation is occurring, where the share of manufacturing in the economy is actually declining, reducing diversification.



Student view

Interactive 1. Exports of Mexico, 2017.

More information for interactive 1

This treemap represents Mexico's export data for 2017 in an engaging and intuitive manner. Users can hover over individual rectangles to reveal detailed information about each product category, including export value and share in total exports. The interface is designed for ease of use, allowing for a quick understanding of the relative importance of different export sectors through a color-coded and size-proportional layout. Each rectangle represents a distinct product category, with its size corresponding to the total export value and its color indicating related product groups. This structure helps visually compare the significance of different industries within Mexico's economy.

In 2017, Mexico's top export was cars, which accounted for a significant portion of total exports. This highlights the country's strong automotive industry and its role as a key player in global automobile manufacturing. Other major exports included motor vehicle parts, delivery trucks, computers, and telephones, reflecting Mexico's integration into international supply chains, particularly in the automotive and electronics sectors. On the other end of the

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spectrum, some of the smallest export categories include specialized machinery, niche agricultural products, and select raw materials, representing a minimal share of total exports. This contrast showcases the diversity in Mexico's export portfolio, with dominant industries coexisting alongside smaller, emerging sectors.

By interacting with this visualization, users can develop a clear understanding of Mexico's major export sectors and their economic impact. They can also gain insights into how international trade is structured, recognizing key industries that drive Mexico's economy. Furthermore, this tree map enhances data literacy by allowing for the exploration of hierarchical data structures in an accessible and engaging way.

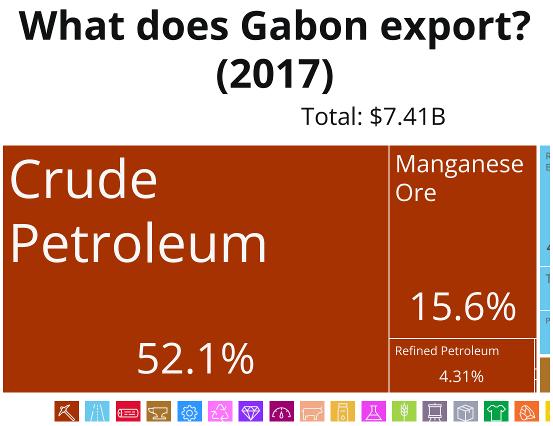

Figure 3. Exports of Gabon, 2017.

Source: "OEC World (https://oec.world/)"

More information for figure 3

This treemap represents Gabon's export data for 2017, providing a dynamic way to explore the country's trade composition. The visualization is designed to be intuitive, allowing users to hover over different product categories to view specific export values and their contribution to total exports.

Each rectangle in the treemap represents an export product category. The size of each rectangle corresponds to the total export value of that product, while the colors differentiate between product groups, helping to quickly identify patterns and trends. This visual arrangement effectively conveys the economic significance of various industries, making complex trade data more accessible.

A notable aspect of the visualization is the dominance of a few key exports. In 2017, crude petroleum was Gabon's largest export, accounting for over half of total exports. This highlights the country's heavy reliance on the oil industry. Other major exports included manganese ore and timber-related products, underscoring the importance of mining and forestry to Gabon's economy. These high-value exports indicate a trade structure primarily based on natural resources.

Smaller export categories, such as rubber, ferroalloys, and gold, contribute only a minor portion to Gabon's total exports. These lower-value exports represent a fraction of the country's trade, reflecting limited diversification. While there are some manufactured goods and agricultural products, their role remains minimal in comparison to raw material exports.

This visualization provides valuable insights into Gabon's export structure, illustrating its economic dependencies and trade balance.

Student view

Countries can use either trade liberalisation or export promotion to diversify their exports. The argument for trade liberalisation is that open trade can encourage investment in countries, helping to cultivate development of a diverse group of products and services in an economy. On the other hand, it can be argued that governments may need to use some forms of protectionism, including subsidies, to help a new and diverse range of infant industries set up and grow.

The UNCTAD report linked earlier in this section points out that in developing countries generally, there is a positive correlation between trade liberalisation and diversification. However, in sub-Saharan Africa this positive correlation does not exist. This suggests that individual domestic policies and institutions have a large role to play in levels of diversification.

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Case study

Saudi Arabia and diversification

Many oil-producing countries are over-specialised and dependent on the primary product. An example is Saudi Arabia. According to OPEC, the oil and gas sectors account for about 50% of Saudi Arabia's GDP and 70% of export earnings. When oil prices are high, the country has benefited from enormous export revenues through the partly state-owned oil company Saudi Aramco. However, when oil prices decline, as they have recently during the COVID-19 pandemic, the country is vulnerable, especially since the vast majority of government revenues are generated through the sector.

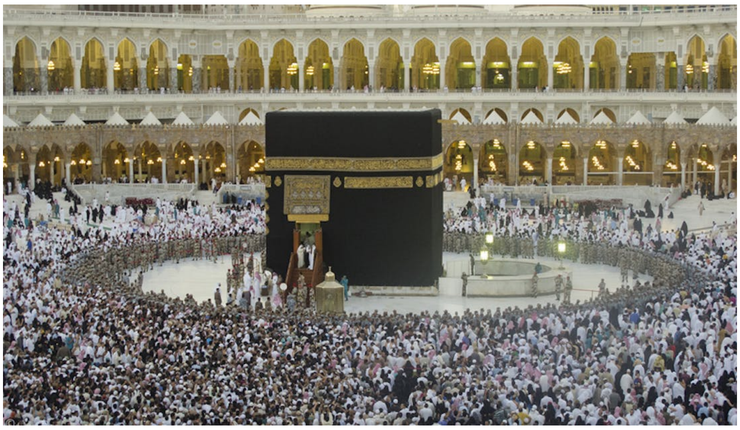

Figure 4. Saudi Arabia is seeking diversification away from oil exports. Pilgrimages for the Hajj bring millions of visitors a year to the country.
Credit: Getty Images orhandurgut

Saudi Arabia has a long-term plan, called Vision 2030 (https://vision2030.gov.sa/en), to modernise its economy and improve development. One component of this plan is to diversify its economy away from oil exports. Much of this plan relies on developing a tourism industry. **Figure 4** shows part of the annual pilgrimage to the city of Mecca in Saudi Arabia, called the Hajj. In 1950, 50 000 pilgrims traveled to Mecca. In recent years, millions have gathered in Mecca for the Hajj and represent a growing source of revenue for the country. Saudi Arabia is developing plans for other tourist attractions as well.

Student view

Vision 2030 includes a number of objectives:

- Strengthen Islamic and national identity
- Offer a fulfilling and healthy life
- Grow and diversify the economy
- Increase employment
- Enhance government effectiveness
- Enable social responsibility

To what extent might Saudi Arabia's attempt to diversify its economy by expanding tourism conflict with the other objectives listed in Vision 2030?

Exam tip

The most likely way you will be examined on the material in subtopic 4.10 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30433/) is in a longer response in Paper 2 that asks you to discuss, evaluate or compare/contrast strategies to improve economic growth and/or development.

Before you write such a response, you should take a few minutes to develop a basic outline. This can help you develop clear, focused paragraphs that show an examiner that your knowledge is solid and that you are able to engage with the text material.

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Remember that your time is limited. You need to be aware of your own limitations in terms of writing and thinking speed to determine how many points you can cover. In any case, an organised response will earn you more marks than a disorganised response because the examiner will be able to follow it more easily.

The worked example below asks you to develop an outline to a question related to section 4.10.1 (/study/app/pp/sid-186-cid-754025/book/trade-strategies-liberalisation-and-integration-id-30679/) and this subtopic.

Worked example

Discuss trade strategies that Country X might use to improve economic growth and/or development.

Prepare an outline for a response.

If you were preparing this outline under exam pressure it would be condensed into key words. Your outline may not be organised in the same way as this worked example. This is fine. Just have a look at the one below to see whether your outline has clearly defined 'chunks' and a logical progression of ideas like this one.

I. Introduction (keep it brief)

- Define economic growth and development
- Explain the positive feedback loops involved with economic growth and development, or some other relevant link between the two (see section 4.8.1 (/study/app/pp/sid-186-cid-754025/book/the-multidimensional-nature-id-30572/))

II. Trade liberalisation (advantages should be put into one paragraph, disadvantages into a separate paragraph)

- Advantages/strengths of trade liberalisation (select two that you can relate to the text, preferably one associated with economic growth and one associated with development)
  - Explain one economic growth advantage/strength – use a trade diagram or AD/AS diagram to illustrate it
  - Relate the economic growth advantage/strength to the text
  - Explain one development advantage/strength – use the development side of the poverty trap diagram to illustrate it
  - Relate the development advantage/strength to the text
- Disadvantages/limitations of trade liberalisation (select two that you can relate to the text, preferably one associated with economic growth and one associated with development)
  - Explain one economic growth disadvantage/limitation
  - Relate the economic growth disadvantage/limitation to the text
  - Explain one development disadvantage/limitation
  - Relate the development disadvantage/limitation to the text

III. Import substitution – follow the same format as II. You can refer to your diagrams for II if relevant.

IV. Conclusion

- Synthesise ideas, perhaps through a brief comparison of one or more points on the two strategies
- Make a judgment/take a position about which strategy is more appropriate for the country in its circumstances
- Justify your judgment – why is it right?

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Complete section with 3 questions

Start questions

Section

Feedback

Previous section(/study/app/pp/sid-186-cid-754025/book/trade-strategies-liberalisation-and-integration-id-30679/)

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Student view

4. The global economy / 4.10 Economic growth and/or economic development strategies

Social enterprises

An entrepreneur is someone who is able to combine the factors of production to create a business that produces a good or service, and is rewarded with profit. Social enterprises are businesses whose primary objective is to improve social or environmental conditions. Social enterprises earn revenues, and often have surpluses, but these are put back into the business to serve their social or environmental stakeholders. They can be classified either as for-profit or not-for-profit organisations.

An example of a social enterprise is d (https://www.dlight.com/).light (https://www.dlight.com/), a firm providing low-cost solar energy solutions for the two billion people globally who do not have access to reliable energy. It has sold more than 20 million solar light devices in 70 countries. You can see the story of its social enterprise in the short video below.

Social enterprises typically emerge in one of three ways. In some cases, non-governmental organisations that operate as charities and rely on donations move to an entrepreneurial approach, by providing goods and services that earn revenues. Secondly, some more traditional for-profit companies shift their primary focus and mission to social and/or environmental goals, and away from pure profit maximisation. Finally, there are social enterprises like d.light that have combined social impact and revenue/profit from their inception.

Regardless of how they come about, social enterprises often need finance to start up, grow and meet their objectives. Loans, particularly from sustainable banking institutions, angel investors, crowdfunding, social venture capital, impact investment funds (see Acumen Fund case study below), and government-funded loans and grants are some of the channels where social entrepreneurs get seed money to build their businesses. They do not usually use traditional venture capital, which expects high profits in a short period of time and whose objectives do not align well with most social enterprises.

Making connections

In the IBDP Business Management course, subtopic 3.1 is about sources of finance. Many of those sources are also available to social enterprises. The key difference is that the sources expect far less return for their investment,

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known as patient capital.

Social enterprises have had huge success in providing goods and services to neglected populations around the world, in sectors where traditional businesses are not interested or government intervention has been ineffective. According to the Skoll Foundation (https://skoll.org/), an impact investor and supporter of social enterprises, successful social enterprises (http://hbr.org/2015/05/two-keys-to-sustainable-social-enterprise) typically address imbalances in systems and markets by creating change in the economic actors involved and/or the technologies used by those actors. In d.light's case, this involved creating appropriate technology (see section 4.9.2 (/study/app/pp/sid-186-cid-754025/book/economic-barriers-infrastructure-id-30582/)): a solar light suitable for low-income consumers' lives in developing countries. As you saw in the video, its business also involved transforming low-income populations into consumers of light.

Case study

Acumen Fund

Figure 1. Jacqueline Novogratz, founder and CEO of Acumen Fund.
Credit: Getty Images Riccardo Savi / Stringer

Student view

The Acumen Fund (https://acumen.org/)is an impact investment fund founded in 2001 by Jacqueline Novogratz (**Figure 1**). It aims to bridge the gap between market-based approaches and philanthropy, mixing the efficiency and scale of enterprise solutions with a social purpose.

The Acumen Fund employs patient capital. As investors, the Fund has a high risk tolerance and a long-term perspective, and provides flexibility for entrepreneurs facing difficult conditions in developing countries. At the same time, the Fund demands that the social enterprises it supports show that they can grow their businesses sustainably over the long term.

The website of the Acumen Fund highlights many examples of the social enterprises it supports and is a great source of inspiration for change makers. They even have courses (https://www.plusacumen.org/)to support budding social entrepreneurs.

Access the Acumen Fund (https://acumen.org/)website and read about two of the projects it has funded in two parts of the world.

To what extent do you see evidence that these projects address imbalances in systems and markets by creating change in:

1. the economic actors involved and/or
2. the technologies used by those actors, as discussed in this section?

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Figure 2. The logo of the Acumen Fund.

Source: "Acumen logo (https://commons.wikimedia.org/wiki/File:Acumen_logo.png)" by James Wu

Complete section with 3 questions

Start questions

Previous section(/study/app/pp/sid-186-cid-754025/book/trade-strategies-alternatives-to-liberalisation-id-30681/)

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Student
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Market-based policies

You have already studied market-based economic strategies in subtopic 3.7 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30420/) on supply-side policies. The labour-market policies you studied there are not really applicable in a developing country context. Low-income countries do not typically have labour unions, minimum wages, or unemployment benefits to adjust. Likewise, the incentive-based policies such as personal and corporate tax cuts are less effective because of the size of informal markets and ineffectiveness of tax-collecting institutions.

However, there are several market-based strategies that can encourage competition and efficiency in markets, covered in subtopic 3.7 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30420/), that are relevant in this context. Trade liberalisation, which we discussed in section 4.10.1 (/study/app/pp/sid-186-cid-754025/book/trade-strategies-liberalisation-and-integration-id-30679/), is one of them. We will also highlight two others in this section within the context of a developing country: privatisation and deregulation.

Exam tip

When you are discussing or evaluating economic policies in the exam, you must always keep the context in mind.

For example, suggesting that a low-income country should adjust minimum wages to affect labour markets may not be appropriate, since the dominance of informal markets can make such policies ineffective.

Privatisation

In many economies, governments own significant assets, especially in the telecommunication, infrastructure and banking sectors. Mainstream economic theory suggests that government ownership of such assets is productively inefficient and allocatively inefficient, because governments do not have the objective of profit maximisation . Private owners, on the other hand, are assumed to maximise profits and will therefore work to cut costs and use resources in the best way possible.

In order to improve efficiency in the economy, governments have used privatisation, sometimes at the demand of the International Monetary Fund (IMF) or World Bank in exchange for economic support. Privatisation is the process of selling off state-owned enterprises (SOEs) to private owners. This policy was considered essential to improving economic performance, reducing the subsidisation of state-owned enterprises, and raising revenues for governments, as well as reducing the negative impacts of monopolies on price and efficiency (HL students learned about these problems in subtopic 2.11 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-29858/)). Improved efficiency of productive assets should increase long-run economic growth and the material dimension of development. These theories and assumptions dominated from the 1980s to the early 2000s.

However, as the World Bank notes (https://elibrary.worldbank.org/doi/pdf/10.1093/wbro/lkx007), the privatisation discussion has evolved in recent years as countries and academics have learned from the difficulties of privatisations and have seen some privatisation failures. There is now an awareness that privatisation, by itself, does not necessarily result

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in improved efficiency and can, in fact, have significant negative impacts on equity. Context matters and privatisation needs to be adapted to local conditions. Furthermore, although the privatisation of SOEs raises revenue at the point of sale, the government no longer receives the revenue of these enterprises after they have been sold.

Before 2015 China was one of the top privatising countries. However, privatisation has not been complete. Large state-owned firms have been 'corporatised' instead of fully privatised. This means that a minority share of the firm is traded in the stock market, but the state remains a controlling shareholder. Privatisation in sub-Saharan Africa has been slow partly due to a lack of political commitment and opposition from ministries, and partly because the SOEs themselves and public sector workers fear that privatisation may cost them their jobs.

The World Bank has noted that there are a number of factors that can influence the success of privatisation, including:

- identifying appropriate firms to privatise
- whether privatisation is partial or total. Total privatisation is more likely to yield efficiency gains
- the regulatory framework and how the privatisation is carried out, especially whether powerful individuals are able to corrupt the process
- who the owners are, with foreign ownership yielding greater efficiency improvements
- the level of competition inside the economy for the newly privatised firm, with greater competition yielding greater efficiency gains and lower prices for consumers

Equity must also be considered. In countries that were a part of the former Soviet Union, SOEs were often sold off at very low prices to powerful individuals, resulting in a transfer of wealth from the public to the private sector. These 'oligarchs' who acquired the firms enriched themselves at the expense of the rest of society, worsening income distribution. In Mexico, Carlos Slim amassed enormous wealth from telecommunications privatisation. In 2020 his wealth was estimated at USD 49 billion.

Student
view

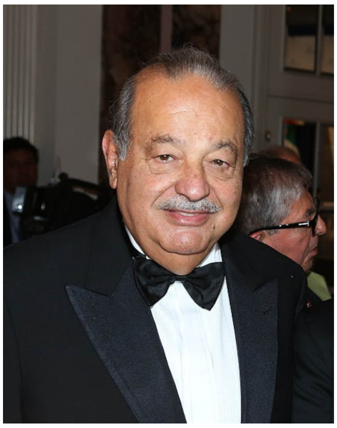

Figure 1. Carlos Slim, a beneficiary of privatisation and one of the richest people in the world.

Credit: Getty Images Rob Kim / Stringer6

Exam tip

Students often forget to include diagrams in their longer exam responses on development topics, but these are critical to maximise your marks.

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When you discuss equity as a benefit or limitation of an economic growth strategy, remember that you can use an abstracted Lorenz curve diagram to show income or wealth inequality improving or worsening as a result of the policy.

Privatisation is a difficult process for governments to undertake, and improvements in efficiency and economic growth are not guaranteed. If economic growth does occur it may improve incomes and the material dimension of development for the population. On the other hand, if done poorly, privatisation can worsen inequality, create unemployment in formally state-owned enterprises and/or result in higher prices when competition for the privatised firms is not strong enough. Governments must ensure that the privatisation process is not captured by elites, as well as ensuring that the economic and regulatory environment will have a positive outcome for the broader population.

Deregulation

Regulations are rules and restrictions that the government creates to ensure that firms behave in a way that is best for social welfare. For example, governments may have environmental regulations that limit CO_2 emissions from factories, require businesses to register their operations and report their earnings, or demand automobile safety standards. These regulations are absolutely necessary to ensure that firms do not harm people in the process of trying to maximise their profits, to prevent market failures, and to ensure that firms' economic activities are reported appropriately for taxation, among other reasons.

Though many regulations are necessary for the public welfare, there are many that are not. Excessive regulation can:

- make it more difficult for a business to start up, adding to barriers to enter markets, reducing competition and raising prices
- make it more costly and time-consuming for businesses to operate, lowering aggregate supply
- offer opportunities for corruption when businesses seek to avoid regulation and government officials see opportunities to leverage their administrative power

Student view

Governments need to weigh up competing objectives. On the one hand, they want entrepreneurs and businesses to produce their goods and services. This increases economic growth, provides incomes and can contribute to development. On the other hand, regulations on firms may be necessary to protect the public interest, including health, safety and employment. Where governments have weighed up these competing interests, and found regulation to be excessive, they have often used deregulation, or removing laws constraining businesses, to improve the economy.

It can be very difficult for governments to find the right balance between deregulation and the public interest. The deregulation of Chile's economy in the 1980s is seen as an example of how deregulation may have large negative consequences for development. Escalating inequality has fuelled unrest in the country (https://foreignpolicy.com/2019/11/23/chile-upheaval-protests-model-muddle-free-market/)that was once hailed by free-market economist Milton Friedman as a 'miracle'.

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Figure 2. Protesters in Chile in 2019. Privatisation and deregulation have left many in the country economically vulnerable and contributed to rising inequality.

The World Bank releases a yearly report, called *Doing Business* (https://www.doingbusiness.org/), that outlines regulations in 190 countries around the world and charts how easy or difficult it is for businesses to operate in different countries. The report ranks countries on the following metrics, which also provides us with a list of ways or areas where reducing regulations could make it less costly and easier for firms to do business. They are:

Starting a business	Dealing with construction permits	Getting electricity	Registering property	Getting credit
Protecting minority investors	Paying taxes	Trading across borders	Enforcing contracts	Resolving insolvency

Student view

Be aware

The World Bank's *Doing Business* report starts from the premise that deregulation is a good thing. While there is contextual awareness in the report, it has been criticised (https://www.commondreams.org/views/2019/11/04/world-bank-rankings-promote-deregulation-expense-working-people)for its role in putting pressure on countries to reduce environmental, employment and/or tax regulations that may be necessary for development. Its conclusions are part of the debate about how, and how far, governments should deregulate their economies.

Table 1 below shows the top 10 countries where it is easiest to start and operate a firm, with some of the metrics included. Notice that three of the Asian Tigers are in the top 10 (Singapore, Hong Kong, Korea); the fourth, Taiwan, is ranked 15th overall.

Table 1. Doing Business 2020, top 10 countries

Country	Overall rank	Starting a business	Getting electricity	Getting credit	Paying taxes
New Zealand	1	1	48	1	9

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Country	Overall rank	Starting a business	Getting electricity	Getting credit	Paying taxes
Singapore	2	4	19	37	7
Hong Kong SAR, China	3	5	3	37	2
Denmark	4	45	21	48	8
Korea, Rep.	5	33	2	67	21
United States	6	55	64	4	25
Georgia	7	2	42	15	14
United Kingdom	8	18	8	37	27
Norway	9	25	44	94	34
Sweden	10	39	10	80	31

Case study

Starting a business in Uruguay

Uruguay is an example of a country that used to have excessive regulations in place to start a business, but has now made reforms to make it easier for entrepreneurs.

In 2003, entrepreneurs in Uruguay had to deposit the equivalent of 212% of the average income per capita into a bank to start a business. Many countries have similar capital requirements to start a business. These are intended to protect creditors when, for example, new businesses get trade credit to acquire supplies. However, research has shown that such capital requirements do not work, and Uruguay's were very high, which made it very difficult for entrepreneurs to start a new business.

Student view

A second difficulty they faced was that paying taxes was very time consuming for firms. There were an average of 55 payments each year, and it took an average of 304 hours of work to complete the paperwork and make the payments. Firms also faced difficulties getting credit from banks to start up.

Today, entrepreneurs in Uruguay decide how much capital they need to start a business. Tax services are now online and the number of payments required has been reduced by one third. Access to credit has been improved and bankruptcy laws have changed to give business owners a chance to reorganise their operations if something goes wrong.

- Why is it important for economic growth and development (consider the three dimensions of development) to make it easy for people to start businesses?

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Figure 3. Opening a business in Montevideo, Uruguay is easier now.
Credit: Getty Images ElOjoTorpe

Worked example 1

Examine the following data in **Table 2** on the ease of doing business in Rwanda from the World Bank's *Doing Business 2020* (https://www.doingbusiness.org/en/doingbusiness)report. Rwanda has the highest ranking among countries in Sub-Saharan Africa. It is ranked 38th in the world.

Table 2. Ease of doing business in Rwanda.

Criterion	Rank	Criterion	Rank
Starting a business	35	Dealing with construction permits	81
Getting electricity	59	Registering property	3
Getting credit	4	Protecting minority investors	114
Paying taxes	38	Trading across borders	88
Enforcing contracts	32	Resolving insolvency	62

Student view

1. Using the data, identify two areas of regulation where it is particularly easy to do business in Rwanda.
2. Using the data, suggest two policies that Rwanda could use to improve the ease of doing business in the country.

1. According to the data, Rwanda is ranked third in the world in terms of how easy it is to register property. This means that there are relatively few regulations that would impede an entrepreneur from setting up a physical location for a business.

2. According to the data, Rwanda is ranked fourth in the world in terms of how easy it is to get credit. This means that entrepreneurs face relatively little bureaucracy when getting loans from financial institutions to start their business.

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Sample response (other approaches are possible): According to the data, Rwanda is ranked 59th in the world in terms of how easy it is to get electricity. This is lower than its overall ranking, suggesting that this is an area for improvement. One reason why businesses in Rwanda could have issues with getting electricity is due to systemic infrastructure problems. Therefore, one policy to improve this metric would be for the government to increase spending on improving the electricity networks, making sure that rural areas, not just cities, are connected to electricity grids. (In section 4.10.8 (/study/app/pp/sid-186-cid-754025/book/interventionist-policies-redistribution-id-30685/), you will read about a recent World Bank loan approved for expansion of electricity services in Rwanda.) In addition, it could be that there is excessive paperwork involved with getting electricity even when the infrastructure is present. If this is the case, the government could reduce the steps or paperwork necessary to access electricity.

According to the data, Rwanda is ranked 88th in the world in terms of how easy it is to trade across borders. This is lower than its overall ranking, suggesting that this is an area for improvement. Protectionism could be one reason why businesses in Rwanda may have issues trading across borders. Therefore, the Rwandan government could ensure that it rapidly complies with its new commitments under the AfCFTA (see section 4.10.1 (/study/app/pp/sid-186-cid-754025/book/trade-strategies-liberalisation-and-integration-id-30679/)), freeing up cross-border trade with its regional neighbours. This would reduce the cost and bureaucracy involved with cross-border trading. According to the data, Rwanda is ranked fourth in the world in terms of how easy it is to get credit. This means that entrepreneurs face relatively little bureaucracy when getting loans from financial institutions to start their business.

Strengths and limitations of market-based policies (privatisation/deregulation)

The strengths and limitations of market-based policies have already been covered in subtopic 3.7 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30420/) and to some degree already in this section. A brief summary using key words is in **Table 3** below.

Student view

Table 3. Strengths and limitations of privatisation and deregulation.

Strengths	Limitations
Economic growth	May reduce equity
Development — multiple dimensions?	May result in market failure
Productive efficiency	May increase unemployment
Allocative efficiency	Ineffective if institutions and complex systems are dysfunctional
Reduced pressure on government budget	Ineffective if informal economy is large

Activity

1. Using the key words in the table above, practise explaining the strengths and limitations of privatisation and deregulation.
2. What diagram(s) could you employ to illustrate these points?
3. If you had to, could you rank these strengths and weaknesses in terms of their importance? Remember that this will be very context-dependent, but you may find it useful to practise arguments about why one strength

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is more important than another, or more important than the limitation(s) or vice versa.

4. If you created a summary table about the strengths and limitations of trade strategies from the previous sections, add privatisation and deregulation to the table as well.

Complete section with 3 questions

Start questions

Previous section(/study/app/pp/sid-186-cid-754025/book/social-enterprises-id-30683/)
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Student
view

Interventionist policies: redistribution

Figure 1. Butaro Hospital at Burera, Northern Province, Rwanda. Rwanda has universal health care and one of the best health care systems in Africa.

Interventionist policies are policies where the government takes an active role in encouraging economic growth and/or development. These policies often have supply-side effects, as you learned in subtopic 3.7 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30420/). For example, government spending on education and health care improves the quality of human capital, causing increases in long-run aggregate supply and potential output.

However, interventionist policies also have demand-side effects, through the increased government spending that usually occurs with interventionist policies. Growth in the economy should also increase employment and incomes, which will have positive demand-side feedback loops that further increase real GDP.

Interventionist policies tend to have larger, more reliable impacts on development than market-based policies. Like market-based policies, they can stimulate economic growth and incomes, leading to an improved material dimension of development. However, interventionist policies tend to have a greater, direct, positive impact on the relational and subjective dimensions of development than market-based policies, whereas market-based policies may have significant negative impacts on these other dimensions of development, particularly equity.

Exam tip

On the exam, you may be asked to evaluate various policies for their impact on growth and development. One generalisation you can make, backed by evidence and examples from text prompts or your own knowledge, is that interventionist policies tend to have larger, more reliable positive impacts on the relational and subjective dimensions of development than market-based policies, though both can increase the material dimension of development.

Redistribution policies

Figure 2. Reduced inequality is an important factor for economic growth and development.

Source: "United Nations Sustainable Development Goals (https://sdgs.un.org/goals)"

Note: “The content of this publication has not been approved by the United Nations and does not reflect the views of the United Nations or its officials or Member States”.

One category of interventionist policies is redistribution policies. Redistribution policies are measures taken by governments to reallocate income and wealth more equitably in society. Governments can do this in a number of ways, such as changing tax structures, making transfer payments, and controlling wages. These policies have already been discussed in subtopic 3.4 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30471/). However, we will address them briefly here with some commentary in the context of low-income countries.

Tax policies

Governments can use the tax structure to redistribute income in a country. One way of doing this is with progressive taxation. This is where higher levels of income are taxed at higher percentages than lower levels of income. Very low levels of income may not even be taxed at all. Progressive taxes should result in higher levels of tax revenue for the government, because high-income earners will pay a larger share of their income. This government tax revenue can then be used for transfer payments or for providing merit goods (section 4.10.6 (/study/app/pp/sid-186-cid-754025/book/interventionist-policies-merit-goods-id-30686/)). Oxfam points out in its Commitment to Reducing Inequality Index 2018 (https://www.oxfamamerica.org/explore/research-publications/the-commitment-to-reducing-inequality-index-2018/)report that if Indonesia increased its tax collection by 2% of GDP, it could more than double its spending on public health.

Low-income countries usually have progressive tax systems. However, as has already been discussed in section 4.9.9 (/study/app/pp/sid-186-cid-754025/book/institutional-barriers-tax-id-30594/), it is difficult for governments in low-income countries to raise money from taxation. There are a number of reasons for this, including the size of the informal and untaxed sector of the economy, the large number of people who fall into an income classification that does not pay taxes, the over-reliance on efficient but not very lucrative indirect taxes, and the ability of powerful high-earning elites to use tax havens to evade their tax responsibilities, among other problems.

As the World Bank points out (https://blogs.worldbank.org/developmenttalk/how-do-taxes-and-transfers-impact-poverty-and-inequality-developing-countries), when governments design tax systems, they need to consider the entire fiscal impact of different types of taxes and transfers on low-income households. The World Bank notes that low-income countries are over-reliant on regressive value-added indirect taxes on basic goods, which have a negative impact on the poor. The dominance of regressive taxation, combined with low levels and poorly distributed transfers, means that many

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low-income households are left poorer by their countries' tax and transfer policies. The World Bank cites Armenia, Ethiopia, Ghana, Guatemala, Nicaragua, Tanzania, Uganda, Bolivia, El Salvador, Dominican Republic, Honduras, Peru, and Sri Lanka as countries where the poor are net payers into the fiscal system.

We can see once again the importance of understanding economies, societies and political institutions through the lens of complex systems. Tax structures can be a tool to improve growth and development in low-income countries, but they must be carefully designed for equity as well as efficiency.

Transfer payments

Transfer payments are payments made by the government to households, to help low-income earners purchase basic necessities. Transfer payments support economic growth, because the recipients use the money to purchase the goods and services they need, boosting consumption. In this way, transfer payments also support the material dimension of development. In addition, the relational dimension of development is supported because transfer payments increase the freedoms and capabilities of low-income groups. It improves income distribution and equity, which has been shown to positively affect subjective well-being too. Clearly, transfer payments have significant positive impacts.

As noted in subtopic 3.4 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30471/), transfer payments come in a number of forms, including old-age pensions to support those no longer working, unemployment benefits for those without paid work, and child allowances to help families pay for the expenses associated with child-rearing. In all cases, governments have to balance the desire to provide a social safety net through transfer payments with encouraging economic actors to take action to support themselves as much as possible. So there is a tension between these objectives that is inherent in the provision of transfer payments.

As the International Labour Organization (ILO) points out (https://www.ilo.org/wcmsp5/groups/public/---dgreports/---inst/documents/publication/wcms_723778.pdf), appropriate policies to support those out of work are likely to differ between advanced and emerging economies. For example, the existence of a large informal sector in low-income countries increases the risk that those receiving government unemployment benefits may also have informal sector work on the side. Those developing unemployment benefit schemes need to account for this. It is also difficult for low-income countries to administer transfer payment schemes and judge recipients' eligibility, due to lack of trained personnel and technological limitations. However, reducing or eliminating unemployment benefits would harm the poorest and most vulnerable in society. Transfer payment schemes, even in less-than-perfect forms, are necessary.

Student view

Unfortunately low tax revenues mean that many low-income countries have limited funding available to provide transfer payments, and many of the poorest countries cannot afford to implement them at all. Therefore you need to be cautious about recommending these as policies to improve economic growth or development in these contexts.

Minimum wage

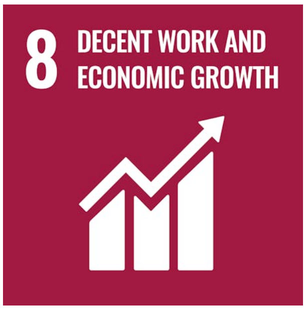

Figure 3. Decent work is an important factor for economic growth and development.

Source: "United Nations Sustainable Development Goals (https://sdgs.un.org/goals)"

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A minimum wage is the lowest hourly wage that an employer is legally allowed to offer a worker. This is a price floor in the labour market, which we have discussed in multiple subtopics in this course. Basic economic theory assumes that minimum wages cause disequilibrium in labour markets and increase unemployment. However, it is important to be aware that those models assume perfect markets, with perfect information and symmetric power between employers and workers. This is not the case in any labour market, and certainly not in developing countries.

The purpose of a minimum wage in a labour market is to protect vulnerable workers from wage exploitation due to relationships with power asymmetry. Minimum wages help ensure that workers earn a living wage that can provide for a normal standard of living in that country. While minimum wages are considered an interventionist strategy in one sense, it is important to understand that they also play a role in limiting government intervention. If employers pay workers exploitatively low wages, governments may have to intervene with transfer payments for the working poor. Therefore minimum wages can play an important role in correcting labour market failure.

Figure 4. Workers in Johannesburg, South Africa protesting for a living wage.
Source: "Workers deserve a living wage (https://www.flickr.com/photos/merajchhaya/14913573346)" by Meraj Chhaya is licensed under CC BY 2.0 (https://creativecommons.org/licenses/by/2.0/deed.en)

Student view

As with other interventions, minimum wages face implementation problems in low-income countries. The large size of the informal sector means that many workers will be unaffected by minimum wage laws. Even in the formal sector, there may be low levels of compliance among employers due to the lack of oversight from administratively-challenged governments, or corruption. Economic theory suggests that if minimum wages are too high, or enforced too strongly, formal-sector employment may decrease and informal sector employment may increase, especially for workers with low skill levels. However, a recent IMF working paper on minimum wages in developing countries shows that the empirical evidence does not back up the theory.

Table 1 lists the minimum wages for a few countries. These wages will change over time, so the list is only accurate as of May 2020. It is interesting to note that some countries have multiple minimum wages for different sectors. For example, in Bangladesh, minimum wages are considerably higher in the ready-made garment (RMG) industry than elsewhere in the economy. These minimum wages are often lower than what would be considered a living wage, especially when inflation rates erode the value of minimum wages over time.

Table 1. Minimum wages for four low-income and two high-income countries.

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Country	Wage Description	Monthly minimum wage (local currency)	Approximate annual minimum wage (US$ at PPP)
Bangladesh	National minimum wage	BDT 1500 per month	564
	Ready-made garment (RMG) industry minimum wage	BDT 8000per month	3000
Nigeria	National minimum wage	NGN 30000per month	2916
Uganda	National minimum wage	UGX 130000per month	1296
Nepal	National minimum wage	NPR 13450per month	4404
Germany	National minimum wage	EUR 1584per month	22872
Australia	National minimum wage	AUD 3208per month	38492

Complete section with 3 questions

Start questions

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Student view

Interventionist policies: merit goods

Merit goods are goods or services that are beneficial for those who consume them and have positive externalities for society. In a free market they are under-provided and under-consumed, so the government will usually provide them to some extent. The Indian state of Kerala (https://www.britannica.com/place/Kerala)is an example of a government that has taken education and health care provision very seriously with significant positive effects on human development over time. The state's ability to respond to the COVID-19 pandemic (https://www.theguardian.com/world/2020/may/14/the-coronavirus-slayer-how-keralas-rock-star-health-minister-helped-save-it-from-covid-19)reveals how important interventionist policies can be for development and resilience.

The benefits of government provision of education, health care and infrastructure have been addressed several times already in this textbook, so we will not spend a great deal of time on this. However, it is worthwhile to look at some examples of specific policies in these areas that can promote economic growth and development.

Exam tip

Students often forget to include diagrams in their longer exam responses on development topics, but these are critical to maximise your marks.

Remember that when you are discussing the provision of merit goods, you can use market failure diagrams to support your points.

Education

Figure 1. Quality education is an important factor for economic growth and development.

Source: "United Nations Sustainable Development Goals (http://https://www.un.org/sustainabledevelopment/sustainable-development-goals/)"

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There are several areas in education where governments can directly intervene with the aim of improving the quality of human capital in the country.

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Arguably, primary education is the most important area in the education sector. Ensuring that all children receive a basic education in literacy and numeracy means that their chances of earning low incomes, of being exploited , becoming involved in crime, or leading unhealthy lives is significantly reduced.

While primary education is important for basic capabilities, secondary and tertiary education are important to enhance human capabilities (see section 4.8.4 (/study/app/pp/sid-186-cid-754025/book/single-indicators-economicsocial-inequality-id-30575/)) and to support an innovative and vibrant research and development sector. As discussed in section 4.7.4 (/study/app/pp/sid-186-cid-754025/book/the-importance-of-resilience-and-id-30438/), the collective learning of a geographic community can make a huge difference to economic growth and development, especially regarding building resilience . Countries where the population has a diverse range of unique 'know-how', practical knowledge or expertise, tend to have more complex economies and a greater ability to continue to expand that diversity.

Figure 2. The public provision of schools is important for building an equitable, inclusive, and resilient society.

Credit: Getty Images hadynyah

Governments in low-income countries face financial constraints on their ability to provide high levels of education to all students. As a result, private, fee-based provision of schooling is more prevalent in the education systems of many developing countries than in developed countries.

Student view

More research is needed to explore the effect of private education in low-income countries; however, a recent UNESCO working paper (https://unesdoc.unesco.org/ark:/48223/pf0000243824)concluded that in some cases, education outcomes in private schools are better, but often still far from desirable levels. Unfortunately, the provision of a merit good like education purely through the private market, even when it is low-cost, will worsen equity.

It is always important for the state to be held accountable for the quality of and access to education. Where good governance is present, educational outcomes are better. Unfortunately, in many cases this governance is lacking for the same reasons that the state fails to provide good public education in the first place. UNESCO concludes that state resources are best spent improving the public system, rather than attempting to adequately monitor a growing and inequitable private system.

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Health

Figure 3. Good health and wellbeing are important factors for economic growth and development

Source: "United Nations Sustainable Development Goals (http://https://www.un.org/sustainabledevelopment/sustainable-development-goals/)"

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Health care is expensive for the government to provide, but it is one of the most important services for a strong economy and high human development. Spending on human health, such as vaccines, delivers far higher returns in economic and wellbeing than the original investment.

Without good health, it is almost impossible for people to achieve any other goal. It is necessary for productivity and income-earning, supporting the material dimension of development. It is also one of the most important factors affecting subjective well-being.

In the recent COVID-19 pandemic, we have seen the importance of health care to economies, communities, families and individuals. In countries where health care is poor, as in many low-income countries, or excessively privatised, like the United States, health outcomes during the pandemic have been particularly poor.

Universal health care

Student view

One of the most important policies a country can have to promote good health and well being is universal health coverage. This ensures that all people in a country have access to the health services they need without facing financial hardship. It should include all essential health services including health promotion, disease prevention, treatment for health problems, rehabilitation from illness and injury, and palliative care.

One strategy for increasing universal health care around the world has been a global network called the Universal Health Coverage Partnership (https://www.uhcpartnership.net/), sponsored by the World Health Organization, the European Union, and other organisations. This partnership provides funding and technical advice to 115 target countries to help them move towards effective universal health coverage.

Vaccines

Vaccines play an important role in improving preventative health care. Vaccines are medicines that stimulate the production of antibodies and provide immunity against one or several diseases. While vaccines are a common, even mandatory part of the health care regimes in developed countries, they are underprovided in developing countries. According to the World Health Organization (WHO) (https://www.afro.who.int/news/despite-gains-access-1-5-african-children-go-without-lifesaving-vaccines), despite considerable progress, about 20% of children in Africa still do not receive important life-saving immunisations. Three diseases – measles, rubella, and neonatal tetanus – have been eliminated in most regions of the world, but are still widespread on the continent.

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Figure 4. Global partnerships with groups like GAVI are an important factor for economic growth and development

Source: "United Nations Sustainable Development Goals (http://https://www.un.org/sustainabledevelopment/sustainable-development-goals/)"

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While partnerships like GAVI (https://www.gavi.org/), mentioned in section 4.9.3 (/study/app/pp/sid-186-cid-754025/book/economic-barriers-international-market-id-30583/), have played an important role in providing funding and access to vaccines, the WHO emphasises that individual governments must take a stronger role in providing vaccines to all children.

Maternal and newborn care

Maternal care is the medical care received by women before, during and after childbirth. Newborn care is the care given to newly born babies. Worldwide deaths related to pregnancy and childbirth dropped by 44% between 1990 and 2015. However, approximately 800 women still die every day from preventable causes related to pregnancy and childbirth. Most of these deaths occur in low- and middle-income countries. Maternal health is closely linked to the survival of newborn babies. Almost half of childhood deaths occur in newborns; they are extremely vulnerable.

Women may have underlying health conditions that make pregnancy dangerous and go untreated. Others do not have access to professional facilities or help during the delivery. Care for mother and baby after childbirth can also be lacking.

Student
view

Figure 5. New mothers and their babies in Burundi. Postnatal support is very important for the health of mother and child.

Credit: Getty Images Buena Vista Images

There are many proven, high-impact interventions – such as training birth attendants, medicines that reduce the risk of haemorrhaging during childbirth, and provision of childbirth medical kits – that do not reach women in low-income

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countries due to lack of funding, medical personnel and facilities. Women in rural areas are particularly at risk, so improving access to these interventions is a priority.

Activity

Oxfam publishes a report called the Commitment to Reducing Inequality Index (https://www.oxfamamerica.org/explore/research-publications/the-commitment-to-reducing-inequality-index-2018/)that researches and ranks countries on the measures they are using to reduce inequality / promote equity. Among the indicators it uses for the Index include those discussed in this section: tax systems, labour policies and government spending on education and health.

Access the latest report and choose a low-income country to focus on. It could be a country you have used in a previous activity, or a different one.

1. How does the country perform on Oxfam's Index on the different indicators?
2. What does the country's performance indicate about development? Consider the role of equity in the material, relational and subjective dimensions of development.
3. How might the country's performance affect economic growth? You are probably used to thinking about what impact growth has on equity, but what impact does equity have on growth?

OXFAM

Figure 6. Oxfam logo.
Source: "Oxfam (https://www.oxfam.org/)"

Student view

Infrastructure

Figure 7. Infrastructure is an important factor for economic growth and development.
Source: "United Nations Sustainable Development Goals (http://https://www.un.org/sustainabledevelopment/sustainable-development-goals/)"
Note: "The content of this publication has not been approved by the United Nations and does not reflect the views of the United Nations or its officials or Member States".

Infrastructure is the large-scale physical capital needed for economic activity to take place. Infrastructure is often, though not always, provided by governments. In section 4.9.2 (/study/app/pp/sid-186-cid-754025/book/economic-barriers-

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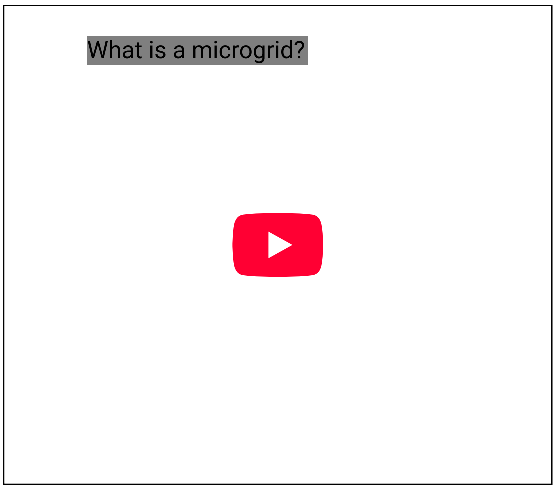
infrastructure-id-30582/), you learned about why infrastructure is so important to economic growth and development, so we will not repeat that here. Instead, we will briefly examine a number of strategies and issues concerning the provision of energy, telecommunications, transportation, clean water and sanitation.

Energy

The ability to produce goods and services in an economy depends on the energy used to produce them. Like developed countries, developing countries rely on fossil fuels for much of their energy production. However, the hope is that future energy sector infrastructure can use renewable sources and more resilient systems.

One possibility is distributed energy systems, where energy production happens locally, rather than being centralised and transported over long distances. Local energy production, for example through solar microgrids as shown in the video below, can improve the resiliency of energy systems by diversifying the power sources supplying an electricity grid, or enabling remote communities to generate their own energy.



Telecommunications

Telecommunications are vital for economic transactions to take place, whether it is for farmers to find out about local market prices, for firms ordering supplies, or for workers receiving incomes. Even in low-income countries, much of the communication in an economy is carried out via telecommunication networks. Telecommunications infrastructure is also vital for development as it expands freedoms and helps maintain relationships between friends, families and communities.

Student view

Mobile technology has transformed the economies of many developing countries, particularly those in Africa. Mobile communications infrastructure is much cheaper to install, and individuals only need to purchase a relatively cheap mobile phone to use the network. According to the International Telecommunication Union, an agency of the United Nations, 97% of all people in the world live within reach of a mobile network. Mobile technology has allowed low-income countries to skip over the expensive landline networks previously used in developed countries. It has become a vital tool in mobile banking, education, disaster relief, governance and health care.

In contrast, only 53% of people globally are using the internet, which the United Nations sees as an enhanced capability. The World Bank is providing loans and grants for countries to improve broadband connectivity, especially to rural areas. It is also forming partnerships with private sector providers to incentivise them to connect hard-to-reach communities. Even when these technologies become available, education and training will need to follow, to ensure that the benefits of the internet are fully realised.

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Transportation

Transportation is vital to move resources, goods and people in an economy, enhancing economic growth and the material dimension of development. It is also essential for the relational and subjective dimensions of development because mobility contributes to freedom and human relationships, connecting people to jobs, education, health care, and friends and family.

Figure 8. Rabat-Salé tram, Morocco.

Credit: Getty Images Andrea Pistolesi

Like many developed countries, developing countries rely heavily on roads for transportation. In rural areas, access to all-weather roads (that do not disintegrate in heavy rain) is very important and further development is needed. However, there is a push to use sustainable transport to ensure inclusive economic growth and expand access to essential services while fighting climate change. The expected high growth of city populations in low-income countries is very promising. In densely populated areas, urban planners can design transportation networks that avoid the mistakes of the car-centred cities of developed countries.

As with telecommunications, the World Bank is providing loans and grants to help countries move towards sustainable transportation solutions. Partnerships with local and regional governments are vital, as is the role of the private sector. Stakeholders are also working to ensure that data and technology is used to maximise the efficiency and improve transportation networks for users.

Student
view

Clean water and sanitation

According to the United Nations, 3 in 10 people do not have access to safely managed drinking water services, and 6 in 10 people lack access to safely managed sanitation facilities. These deficits have an impact on many of the other SDGs, because of their negative impact on human health and other factors.

One important intervention is ensuring that all communities have access to safe, clean drinking water. This does not necessarily mean water piped directly into people's households, which is expensive to provide and maintain, and does not necessarily provide stable access to water (https://qz.com/india/1835544/lack-of-tap-water-makes-rural-india-vulnerable-to-coronavirus/). A big step forward for many of the poorest communities would be a communal water point in each village. This would alleviate the time and physical burden on women and girls, who are responsible for water collection in 80% of households without water access. It would also prevent households from accessing unsafe water sources in their regions, improving the health of entire communities.

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Figure 9. Clean water and sanitation is important for economic growth and development.

Source: "United Nations Sustainable Development Goals (http://https://www.un.org/sustainabledevelopment/sustainable-development-goals/)"

Note: "The content of this publication has not been approved by the United Nations and does not reflect the views of the United Nations or its officials or Member States".

Figure 10. A communal water point can improve development significantly.

Credit: Getty Images aerogondo

Student
view

Sanitation, which includes human and solid domestic waste removal and treatment, is also critical to development through its human health impacts.

According to the United Nations (https://www.un.org/sustainabledevelopment/water-and-sanitation/), almost 900 million people still defecate in the open, which pollutes the environment and spreads disease. Nearly 1000 children die each day due to diarrhoeal diseases that come from water and soils contaminated with human waste. Human waste management through the sewer systems used in developing countries is lacking for a number of reasons. It is costly and invasive to build, there has been a lack of planning of informal housing settlements, and there is a lack of water for removal and treatment.

Research shows (https://washmatters.wateraid.org/blog/sanitation-saving-lives-in-developing-countries)that community action on sanitation is vital to provide the education and physical facilities to change practices in the poorest communities. Like communal taps, construction of communal toilets can be an efficient strategy. Governments can provide these directly, or provide the funding for communities to organise and maintain facilities.

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Non-governmental organisations (NGOs) and the private sector can be important partners to finding innovative solutions to sanitation problems in developing countries. In the video below, Bill Gates of the Bill and Melinda Gates Foundation explains the sanitation problem in developing countries and what path innovation might take.

Strengths and limitations of interventionist policies

The strengths and limitations of interventionist policies have been discussed in subtopic 3.7 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30420/) and in earlier sections of this subtopic, so we will not discuss them again in detail now. The table below provides a summary of the key words.

Table 1. Strengths and limitations of interventionist policies.

Strengths	Limitations
Development — 3 dimensions and the concept of resilience	Government budget implications
Economic growth — AD/AS, factors of production	Governance, including bureaucracy, corruption and short-term thinking

Student view

Activity

1. Practise explaining the strengths and limitations of interventionist strategies using the key words in **Table 1** above and the knowledge you have developed in this and previous sections of the course. You can either do this orally with a partner, or in writing. Be sure to:

- refer to specific interventions and examples mentioned in this and the previous section (look at redistribution policies and provision of merit goods)
- refer to economic growth and development (including all 3 dimensions)
- use economic terminology where appropriate

2. Weigh up the strengths and limitations of interventionist strategies, then reach a conclusion, justifying your position.

3. If you created a summary table about the strengths and limitations of trade strategies, privatisation and deregulation, add redistribution and provision of merit goods to the table as well.

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Complete section with 3 questions

Start questions

Section

Feedback

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Inward foreign direct investment

Trends in FDI

Foreign direct investment (FDI) is long-term investment in a foreign country by multinational corporations. This involves either setting up factories and expanding their operations in the new country or the purchase of at least a 10% share of a foreign company. A multinational corporation (MNC) is a firm that has production facilities in more than one country.

When we use the term inward foreign direct investment (IFDI), this refers to FDI coming into a country. Outward foreign direct investment (OFDI) is FDI leaving a country. This subtopic of the IB syllabus refers to IFDI only, so the discussion of benefits and drawbacks will focus mainly on recipient countries. However, it is important to know that MNCs themselves will experience benefits and drawbacks/limitations on FDI. To the extent that those are related to the experiences of recipient countries, we will also address these in this section.

Making connections

Subtopic 1.6 of the IBDP Business Management course includes the positive and negative impacts of multinational corporations on recipient countries.

There are hundreds of MNCs around the world, many of which you will have heard of, such as Alibaba (**Figure 1**), Apple, Toyota, IKEA, Samsung, and Saudi Aramco. The flow of foreign direct investment from these and hundreds of other multinational corporations are a powerful force for economic growth in the global economy.

Figure 1. Headquarters of the multinational corporation Alibaba Group in Hangzhou, China.

Credit: Getty Images Wang He / Stringer

Traditionally, the vast majority of FDI flows occurred between developed economies. According to the OECD (http://www.oecd.org/investment/FDI-in-Figures-April-2020.pdf), in 2019, Japan, the United States and the Netherlands were the largest sources of outward FDI outflows worldwide. The United States, China, the Netherlands, Ireland and

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Brazil were major recipients of inward FDI.

Since 2000, the distribution of FDI flows has changed, so that developing economies are increasingly *both a source and destination* of FDI flows. In 2013, for the first time, developing economies received more than 50% of global inward foreign direct investment. Outward global foreign direct investment by developing countries has also increased and now makes up just under 50% of the total. This is another aspect of the increased interdependence among developing countries that we discussed in section 4.9.5 (/study/app/pp/sid-186-cid-754025/book/economic-barriers-capital-flight-id-30584/) in relation to debt flows between developing countries.

Figure 2 shows the trends over time for global foreign direct investment in monetary terms, and as a percentage of total world GDP (for all countries, not just developing countries).

Figure 2. Global FDI flows, 2006—2021.

Source: "OECD (https://data.oecd.org/fdi/fdi-flows.htm#indicator-chart)"

More information for figure 2

Student view

Worked example 1

1. Use the data in the graph above to describe what has happened to global FDI flows from 2015–2019.
2. Given the COVID-19 pandemic, explain what happened to global FDI flows in 2020.
3. How might developed and developing countries differ in terms of the likely changes to inward FDI flows in 2021 due to the pandemic – which group is likely to see a larger reduction/increase and why?

1. The graph has two vertical axes, so descriptions of the data could include reference to the monetary value of global FDI flows and/or the FDI flows as a percentage of global GDP. (Just select the option under "Perspectives")

   Flows of foreign direct investment have been broadly declining since 2015. In 2015, the value of FDI flows was approximately USD 2 trillion (USD 1 720 billion) or about 2.3% of global GDP. In 2018, this dropped to approximately USD 1 trillion (USD 940 billion) or 1.1% of global GDP.

   In 2019, FDI flows increased to USD 1 118 billion or approximately 1.3% of global GDP. Despite the 2019 increase, global FDI flows remained below 2015 levels.

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1. The COVID-19 pandemic has reduced global FDI flows significantly. The ban on the movement of people made it difficult for cross-border transactions to take place. In addition, the uncertainty makes it unwise for multinational firms to expand operations abroad or to merge or takeover foreign firms. (As of April 2020, the OECD expects (https://read.oecd-ilibrary.org/view/?ref=132_132646-g8as4msdp9&title=Foreign-direct-investment-flows-in-the-time-of-COVID-19)global FDI flows to decline by more than 30% under an optimistic scenario).

1. According to the OECD (https://read.oecd-ilibrary.org/view/?ref=132_132646-g8as4msdp9&title=Foreign-direct-investment-flows-in-the-time-of-COVID-19), developing countries are likely to experience larger declines in their inward FDI because the sectors that have been severely impacted by the pandemic, including the primary and manufacturing sectors, account for a larger share of their FDI than in developed economies.

Strengths of FDI for recipient countries

Foreign direct investment has a number of the same economic benefits as investment from a domestic firm.

Economic growth and employment

Though it is not explicitly mentioned in the syllabus, it is important to understand why multinational corporations in developed countries find investment in developing countries attractive (from the investors' perspective, called outward foreign direct investment).

Firms can increase the size of their markets, allowing them to increase their potential revenues and profits, by producing and operating in more than one country. This is true for the OFDI from MNCs in both developed and developing countries.

Student
view

For MNCs from developed countries, many developing countries are attractive because of their rapid population growth and rising incomes. China and India, with their very large populations and rapidly growing economies and consumer incomes, have been particularly attractive for multinational corporations wishing to grow their customer base and revenues. According to a World Economic Forum report (http://www3.weforum.org/docs/WEF_Future_of_Consumption_Fast-Growth_Consumers_markets_India_report_2019.pdf), India's consumer spending is expected to grow from USD 1.5 trillion in 2019 to nearly USD 6 trillion by 2030.

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Figure 3. India's large and growing population, relative youth and rising incomes are attractive for MNCs.

Credit: Getty Images Anica Zhlsdorf / EyeEm

For MNCs from developing countries, external markets are very attractive because their own countries markets may be too small or the consumers' incomes too low to maximise revenues. Although Mexico's Cemex corporation does not have a small domestic market, it is an example of a multinational corporation that has been able to profit from economic growth in the 24 countries in which it operates, providing building materials.

According to economic theory, investment is a component of aggregate demand. When FDI increases, aggregate demand and economic growth should also increase, ceteris paribus. Positive feedback loops associated with this increase in investment can foster further economic growth, as we saw in section 4.9.1 (/study/app/pp/sid-186-cid-754025/book/poverty-traps-poverty-cycles-id-30581/).

Student view

Increased production is likely to require more labour, so employment should increase as well. Wages in the firms set up by multinational corporations may be higher than the domestic average, and workers from rural areas may be attracted to commercial centres. This has been the case in China over the past few decades. However, it is important to remember that although wages may be higher than the domestic average, they may still be lower than international norms and living wage standards. If average incomes increase, this should improve the material dimension of development. To the extent that those in poverty may have more occupational and geographic mobility and freedom due to FDI, this can also improve the relational and subjective dimensions of development.

Efficiency and productivity

Foreign direct investment from multinational corporations can increase competition in the recipient country. This will improve efficiency as firms attempt to lower costs of production. Productivity may also increase if MNCs integrate domestic firms into their production processes, provide new technologies to companies and train employees.

Diversification

FDI can provide new industries that would normally take much longer to establish . This can result in diversification of the country's economy, with all the associated benefits of increased economic resilience.

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Another benefit of the diversification may be an increased variety of products and services available to consumers in countries receiving FDI. Just as MNCs see FDI as an opportunity to expand their markets, countries receiving the FDI may see more and different goods and services available in their markets.

Improved infrastructure

New firms and industries can bring with them better roads, electricity, telecommunications, and other infrastructure . Although these may also be built by foreign firms, the projects will need local employees and will help to improve the efficient transport of goods and services. The faster information and goods can travel, the more efficiently markets can work and countries can start reaching their economic potential.

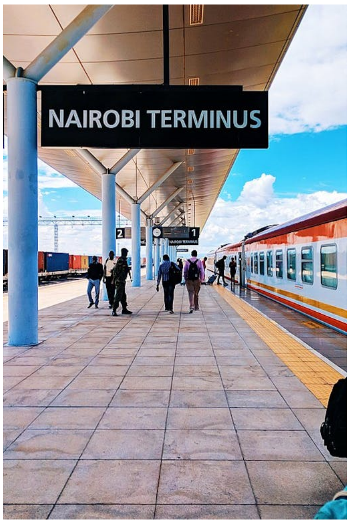

Figure 4. Nairobi Terminus.

Source: "Nairobi Terminus (https://commons.wikimedia.org/wiki/File:NairobiTerminusRailStation_Inzei.jpg)" by Inzei is licensed under CC BY-SA 4.0 (https://creativecommons.org/licenses/by-sa/4.0/deed.en)

Student view

For example, the China Road and Bridge Corporation (state-owned) funded a Kenyan rail line connecting Mombasa and Nairobi that opened in 2017 and it continues to fund other infrastructure projects in the region. All over Africa, many large-scale infrastructure projects are being carried out by Chinese multinational corporations (with state backing). This will improve resource extraction from countries in the region, enable Chinese multinationals to operate more efficiently with lower costs of production, and support the transport of goods from African ports to rapidly growing consumer markets in the region. The positive impacts of improved infrastructure should also benefit entire populations, not just the firms. However, it is important to be aware that some of these projects are financed by unsustainable government debt in the recipient countries. This debt problem was discussed in section 4.9.5 (/study/app/pp/sid-186-cid-754025/book/economic-barriers-capital-flight-id-30584/).

Skills and knowledge transfer

Workers in new industries developed by FDI may gain skills and knowledge through training and new experience . This should improve the quality of labour resources in a country, increasing long-run aggregate supply and potential output.

These new skills may translate into higher income and improve the material dimension of development for workers. It may also give them more freedom and choice, and occupational and geographical mobility that improves the relational and subjective dimensions of development. Many Bangladeshi women employed in the ready-made garment industry have been able to escape forced marriages and dowry arrangements and have greater financial independence, even while they are supporting families back in rural villages. This is causing a major shift in the position of women in society.

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Source of tax revenue

Firms that operate abroad will have to pay taxes in those countries. Taxes might include VAT on sales and corporation tax on profits. This should give the country receiving FDI a valuable source of income that it can use to invest in its public services.

As we learned in section 4.9.9 (/study/app/pp/sid-186-cid-754025/book/institutional-barriers-tax-id-30594/), low-income countries have difficulties generating tax revenues partly because of the size of the informal economy. They rely disproportionately on indirect taxes and corporation taxes, as well as tariffs. This means that the taxes of multinational corporations are a very important part of many countries' budgets.

Limitations/disadvantages of FDI for recipient countries

As you will see in this section, many of the benefits for multinational corporations of their OFDI represent limitations or downsides for the IFDI of the recipient countries. FDI is not a zero-sum game between MNCs and the recipient country, but it is important to be aware of the limitations of the benefits of IFDI, as well as some significant problems associated with it.

Loss of control of capital assets, innovation, human capital and intellectual property

Some multinational firms (and the governments that may support them or have partial ownership) may wish to acquire the physical capital and intellectual property of foreign firms and countries. Where innovation in the home country is lacking, buying foreign firms or setting up production facilities abroad and hiring knowledgeable workers and managers may help those firms (and their countries) to acquire new technologies and talented human capital.

Multinational firms in China, many of which have government co-ownership, have been a leader in this strategy, targeting their OFDI to acquire technologies and intellectual property. Increasingly countries have become wary of OFDI from Chinese firms and have placed increased restrictions on Chinese investment in critical sectors. For example, in 2020, Germany tightened restrictions in fields including artificial intelligence, robotics, semiconductors, and biotechnology, in addition to the energy, water, telecommunications and defence sectors, which already had these restrictions.

Student view

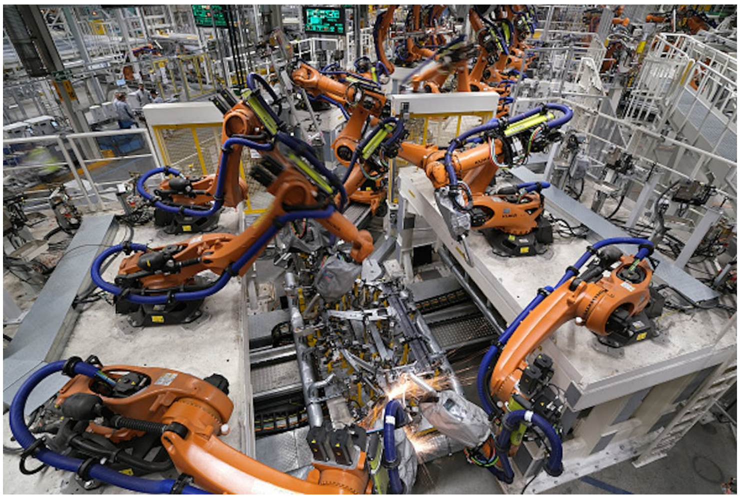

Figure 5. The Chinese takeover in 2016 of German robotics firm Kuka caused the German government to rethink its openness to FDI.

Credit: Getty Images Sean Gallup / Staff

It is relatively common to place restrictions on FDI to avoid some of its downsides. Restrictions may include:

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- a requirement that multinational corporations partner with local firms in joint ventures
- screening for approval to ensure that intellectual property vital for national security is not stolen
- a requirement that a certain percentage of local personnel are hired

The OECD has published a list of such restrictions (https://goingdigital.oecd.org/en/indicator/74/)for its member countries, shown in **Figure 6** below. Where these restrictions are high, investing in production facilities abroad may be less attractive. For example, Indonesia places more restrictions on IFDI than other OECD countries, particularly relating to joint ownership of production facilities.

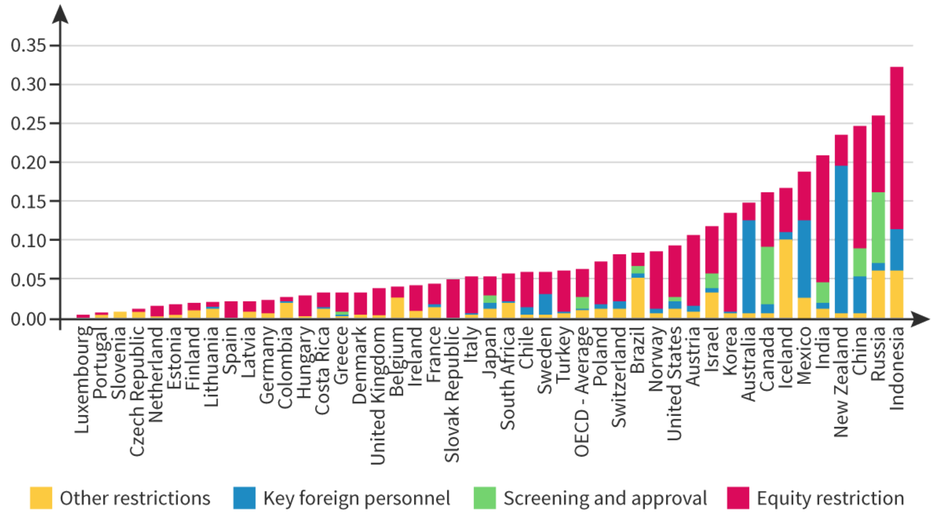

Figure 6. Restrictions on FDI in OECD countries.

Source: https://data.oecd.org/fdi/fdi-restrictiveness.htm (https://data.oecd.org/fdi/fdi-restrictiveness.htm)

More information for figure 6

The bar chart displays restrictions on Foreign Direct Investment (FDI) across various OECD countries. The X-axis represents the countries: Luxembourg, Portugal, Slovenia, Czech Republic, Netherlands, Estonia, Lithuania, Spain, Latvia, Colombia, Hungary, Costa Rica, Greece, Denmark, United Kingdom, Belgium, Ireland, France, Slovak Republic, Italy, Japan, South Africa, Chile, Sweden, Turkey, OECD - Average, Poland, Switzerland, Brazil, Norway, United States, Austria, Israel, Korea, Australia, Canada, Iceland, Mexico, New Zealand, India, China, Russia, and Indonesia. The Y-axis represents the restrictiveness index ranging from 0.00 to 0.35.

The chart is color-coded with four categories: Other restrictions (yellow), Key foreign personnel (blue), Screening and approval (green), and Equity restriction (red). Each bar is segmented according to these categories, showing the contribution of each restriction type for each country.

Indonesia has the highest level of restrictions with significant contributions from 'Equity restriction' and 'Screening and approval' categories. Following Indonesia, Russia and China also show high restriction levels, predominantly due to 'Equity restriction'. Many Western European countries, notably Luxembourg, Portugal, and Slovenia, have the lowest restriction levels. The average restriction level for the OECD is indicated around the middle of the chart. The chart highlights a general trend where non-Western countries show higher FDI restrictiveness compared to Western countries.

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Student view

Repatriated profits: the limitations of positive economic feedback loops

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MNCs may wish to move profits out of a foreign country and bring them home to pay shareholders or other groups. They may also move profits to tax havens. In either case, this means that there will be less reinvestment in the recipient country than if the firms were domestically owned. This is why less economically developed countries tend to have higher GDP than GNI. Remember what we learned in subtopic 3.1 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-29927/):

Gross national income = gross domestic product + net property income from abroad

In the case of less economically developed countries, domestic production will be owned by multinationals, and accounted for in GDP. However, the profits earned from that production may be sent home (repatriated), so the net property income value for the developing country will often be negative, causing a lower GNI value.

So, although FDI should increase aggregate demand and GDP, we may see fewer positive feedback loops accelerating economic growth and development in the economy than would be the case if the investment occurred domestically.

Environmental damage

Figure 7. The polluted and over-extracted Turag River in Dhaka, Bangladesh.

Credit: Getty Images zelg

Student view

Countries have different factors of production, called factor endowments , to use to produce goods and services. Firms may choose to expand abroad to make use of differences in these endowments, including natural (land) resources or human (labour) resources. This is a motivation for MNCs in both developed and developing countries.

For example, the Dutch multinational oil company Shell is a major investor in Nigerian oil production. Its assets include approximately 50 producing oil fields, 5 000 kilometres of oil and gas pipelines, 5 gas plants and 2 oil export terminals. It is clear that access to Nigeria's oil resources is the reason for the foreign direct investment in the country. In terms of labour resources, in Bangladesh many multinational firms have set up ready-made garment (RMG) factories to access the country's abundant labour resources (see 4.10.13 (/study/app/pp/sid-186-cid-754025/book/investigation-id-30688/)). In both cases, the firms are using, some would say exploiting, the resources of the country.

It is vital that governments use regulations to protect the environment. However, regulations differ significantly from country to country, both in terms of existence and enforcement. Firms that generate excessive negative externalities of production in their manufacturing may seek to produce their goods in countries with weak environmental regulation, so that they can lower the costs associated with reducing waste and emissions. Some powerful

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multinational firms also have a history of blocking improved environmental regulations that would negatively affect their own costs. These cost savings can be considerable for the firm, but are associated with increased external costs for the population and the environment.

Limitations on tax revenue gains

In order to attract foreign firms, a government may give them exemption from taxation. This is often done in particular geographical areas, or special zones in cities. Multinational firms are large and have significant bargaining power, and may be able to negotiate these agreeable terms. This means less tax revenue and fewer opportunities for the country to benefit from the foreign investment.

However, as we discussed in section 4.9.9 (/study/app/pp/sid-186-cid-754025/book/institutional-barriers-tax-id-30594/), an MNC's decision to locate operations in a country is based on many factors that include natural resources, infrastructure, workforce and political stability. The IMF claims that tax incentives are typically the least important factor, suggesting that many low-income countries are losing out on revenue by offering them. In 2017, Christine Lagarde, then managing director of the IMF, warned countries not to engage in a 'race to the bottom' on taxes (https://www.reuters.com/article/davos-meeting-outlook/lagarde-warns-of-race-to-bottom-on-trade-regulation-taxes-idUSL5N1FA2BZ).

A second problem with tax revenues is that multinational corporations often take advantage of complicated tax codes, exploiting differences in tax systems across different countries. They can significantly reduce their tax bills by using tax exemptions and loopholes, or shifting their profits to low- or no-tax jurisdictions. This is called base eroding and profit shifting (BEPS). Many large multinational technology companies have been accused of aggressively using these loopholes to avoid tax, including Amazon, Apple and Google.

All countries lose out when profitable firms avoid taxes. The OECD estimates (https://www.oecd.org/tax/beps/about/)that countries lose up to USD 240 billion in tax revenues due to these practices. Other international groups claim the value is much higher. Tax avoidance is particularly damaging for developing countries because they rely disproportionately on corporate tax revenues. It worsens equity and undermines tax compliance everywhere by setting a bad example. This video (https://www.oecd.org/tax/beps/about/)from the OECD very clearly explains BEPS practices and why BEPS is damaging.

Student view

Limitations on labour gains

One reason that MNCs engage in foreign direct investment is lower wage costs, especially in countries with high population growth rates and young populations. You could see some of this variation in minimum wage laws in **Table 1** in section 4.10.5 (/study/app/pp/sid-186-cid-754025/book/interventionist-policies-redistribution-id-30685/). In addition, firms may find that some countries have more lenient labour regulations, in terms of maximum working hours or other working conditions. Fewer regulations, or loose enforcement of regulations, can also lower firms' labour costs.

Different or changing labour costs can significantly affect where companies choose to produce their goods and services. For example, as labour costs have risen in China in recent years, a number of large multinational firms have decided to leave China to operate in other countries, such as Vietnam.

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Figure 8. A factory in China. Rising wages there are causing some multinational firms to move to countries with lower labour costs.

Credit: Getty Images Mick Ryan

This profit-maximising behaviour with regard to wages may limit the income and skill gains for labour in the country that receives the FDI. Firstly, if the MNC is the dominant employer in a region it will have asymmetric power in labour negotiations, which can keep wages low. As Christine Lagarde noted with taxes, countries may also engage in a race to the bottom on wages. Governments interested in keeping the MNC in the country or region may not support measures to balance power for workers in labour negotiations. In some cases, human rights may be violated in the name of keeping costs low.

Secondly, employment opportunities for domestic workers may only be low-skilled in nature, with managerial roles reserved for foreign employees who are sent to the developing country by the MNC. Although this may make sense while the industry establishes itself with the help of foreign knowledge, there is no guarantee of training and promotion for domestic workers even after the industry is established.

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MNC dominance and lower resilience

Instead of increasing competition in an economy, sometimes large MNCs may be the only firms operating in the host country in a particular market. This may be a coincidence or it may be because they have used aggressive marketing strategies. Some firms flood their new market with products priced below the cost of production to push out the competition. This is known as dumping , and is illegal. Firms may also have arranged monopoly positions with the government. This will ensure high revenues, but is also likely to result in inefficiency and misallocation of resources.

In addition, it may be that over time one MNC comes to dominate a country's production and exports because of the favourable business climate there (see case study below). Just as it is dangerous for a country to become over-dependent on a particular primary product export, it is also dangerous for a country to become dependent on one or a few MNCs. If the dominant company has financial problems, the country could find its economic gains from FDI wiped out.

It is important to develop economic resilience through diversification. FDI can help with that, but it is also possible for dominant firms to threaten resilience.

Case study

FDI in Vietnam

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Figure 9. Vietnam is receiving high levels of FDI.
Credit: Getty Images Snyde88

More information for figure 9

The Samsung electronics factory in Thái Nguyên in Vietnam has more than 60 000 employees and makes more mobile phones than any other factory in the world. Samsung has invested USD 17 billion in Vietnam and its factories there produce a third of the company's output globally.

The local Samsung subsidiary is the biggest company in Vietnam, with more than USD 65 billion in revenue in 2018, and it employs more than 100 000 people. The company accounts for more than 25% of the country's GDP. Provinces hosting Samsung factories have seen incomes rise significantly. Services for the workers have increased in the region, and suppliers to Samsung have increased in number. This demonstrates the positive feedback loops that can emerge with FDI.

Vietnam is attractive for South Korea's Samsung. The workforce is young and wages are half those in China. The low wages help Samsung keep its prices below its main competitor, Apple. The Vietnamese government, though communist in name, is pursuing policies of trade liberalisation, including deregulation and privatisation, as part of the Trans Pacific Partnership (TPP), a regional trade agreemen t. It also offered Samsung tax breaks and a rent exemption to attract the company to the country.

However, the company has been accused (https://ipen.org/documents/electronics-workers-vietnamese-women-report)of poor working conditions for its employees in factories. Long hours standing, alternating day and night shifts, and exposure to toxic chemicals negatively affect workers' health. The company has more recently responded to allegations (https://news.samsung.com/global/samsungs-commitment-to-our-workers-in-global-operations), outlining the measures it is taking to protect workers.

Write a commentary of about 400 words applying 3—4 elements of the theory on FDI to the case of Samsung in Vietnam.

Alternatively, discuss the case with a partner, identifying 3—4 (or more) links to the theory from this section.

Student view

Activity

If you created a summary table about the strengths and limitations of the previous strategies, add FDI to the table as well.

Section   Feedback

Complete section with 3 questions

Start questions

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Previous section(/study/app/pp/sid-186-cid-754025/book/interventionist-policies-merit-goods-id-30686/)

Next section (/study/app/pp/sid-186-ci

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Foreign aid

Aid is any assistance given to a country that would not have been provided through normal market forces. Aid can be given by many different groups and for many different reasons. Trends in aid can vary greatly from year to year as countries change their budgets for foreign aid. Aid also ebbs and flows in response to specific crises and development priorities.

Figure 1. Partnerships for the SDGs include aid partnerships.

Source: "United Nations Sustainable Development Goals (https://www.un.org/sustainabledevelopment/sustainable-development-goals/)"

Note: "The content of this publication has not been approved by the United Nations and does not reflect the views of the United Nations or its officials or Member States".

International Mindedness

Countries supporting each other in times of need is fundamental to what it means to be internationally minded.

Humanitarian aid

Humanitarian aid provides direct support for regions that are currently experiencing difficulties that prevent people from fulfilling their basic needs. Climate shocks, infectious disease, and armed conflict increased the number of people in need of humanitarian assistance by 22 million in 2019, according to the United Nations. These trends are expected to continue and worsen.

The needs for 2020 and beyond are likely to increase even further than forecast as the COVID-19 pandemic plays out in low-income countries. Even before the pandemic, the United Nations was predicting that about 168 million people, or about 1 in 45 people on the planet, would need humanitarian aid in 2020, the highest number in decades.

Though total deaths due to armed conflict have been declining over the past few decades, one disturbing trend is that these conflicts are killing and harming record numbers of children. Yemen, where 80% of the population needs humanitarian support after five years of civil war (https://www.bbc.com/news/world-middle-east-29319423), has been the worst affected. Globally, women and girls are seeing an increased risk of gender-based and sexual violence, a trend that has been made worse in the quarantine conditions and social stress caused by the COVID-19 pandemic.

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Figure 2. Yemeni children inspect the damage after an airstrike in 2019.

There are a number of different types of humanitarian aid.

Food aid

Food aid is given to reduce hunger during times of emergency or for longer-term needs. Food can be provided directly or through food subsidies and price agreements. The worst food crises today are generally linked to simultaneous climate and conflict shocks. However, at the time of writing this text, it was clear that the COVID-19 pandemic would cause major disruption to food supply chains (https://www.theguardian.com/global-development/2020/may/15/west-africa-facing-food-crisis-as-coronavirus-spreads)and worsen hunger for the world's poorest.

Food aid in times of crisis is extremely important to prevent starvation for groups of people affected by conflict and climate change. However, food aid has to be given carefully, to avoid destroying essential local food markets. This is important because a country needs its farmers and food suppliers for its long-term food security.

Student view

Medical aid

Medical aid consists of providing medical support, equipment or even personnel to areas in need. Disaster relief usually includes medical aid, but aid may also be needed for longer-term problems. Countries with underdeveloped health care systems may find it difficult to combat disease. An international effort has managed to rid the world of smallpox and, in 2016, almost of polio. Aid also played a major role in fighting the recent Ebola outbreak in western Africa.

Emergency relief aid

Emergency relief aid is aid given to populations affected by severe natural or man-made disasters. Every year, disasters such as floods, droughts, tropical cyclones, earthquakes, volcanic eruptions and accidents require mobilisation of enormous emergency resources. These include food, shelter, medical supplies, clothing and other needs. If conditions on the ground are difficult it can be challenging to get the aid to the people affected by the disaster.

Two of the deadliest natural disasters in the last 20 years are the 2004 Indian Ocean earthquake and tsunami that killed more than 220 000 people, and the 2010 earthquake in Haiti that killed between 100 000 and 300 000 people. In both cases, emergency relief aid helped to prevent the death tolls from being much higher.

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Figure 3. Aid arriving in Haiti the day after the earthquake in 2010. Conditions on the ground made it difficult to reach people quickly.

Credit: Getty Images Stocktrek Images

Development aid

Aid that is provided with the aim of achieving development in the longer term is called development aid. This type of aid helps to improve the institutions, infrastructure and industry that are needed for economic growth and development.

Reasons for development aid and types of aid

Many countries and organisations are genuinely motivated by wanting to support others, in the spirit of SDG 17. However, there are also a number of positive consequences for countries that provide development aid. These include improving political relations, providing opportunities for bilateral trade, and improving global security.

Some countries may also use aid to help their own industries through tied aid. This is where the donor country requires the receiving country to make special arrangements with certain businesses from the developed country, or to agree to only trade certain goods and services with that country. This limits the ability of the developing country to make its own choices about trade, and might result in inefficient allocation of resources, limited choices for individuals and higher prices.

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Table 1 lists a number of other types of development aid.

Table 1. Other types of development aid

Grants	**Grants are financial gifts that do not need to be paid back.**
Concessional loans	These are loans with generous terms and conditions such as: • having no interest rates at all • having very low interest rates (below market rate) • being repayable over a very long time • including a period during which no repayments need to be made and they can • being repaid in the national currency, which makes it easier as the country does not have to acquire foreign currency. Often, there are requirements for how the money will be used, such as on education or health care. Conflicts may arise between donor and recipient over the requirements.

	Grants are financial gifts that do not need to be paid back.
Project aid	This refers to aid that comes in the form of funding for small, short-term projects, which will be useful for the country long term. For example, building a school or hospital may be overseen by a development organisation or another country, but once the project is complete, the recipient country has control over the resource to serve the needs of the local people long after the financial support for the project ends.
Programme aid	This is long-term aid that supports improvements in an entire industry or sector, such as the financial sector. As you have learned, improving the banking system is vital for economic growth, as credit markets and financial intermediaries facilitate new business start-ups and growth.

Official Development Assistance (ODA)

When development aid is given by governments it is called official development assistance (ODA). Governments will often set an annual budget for this and the United Nations sets an ODA target of 0.7% of GNI per country for developed countries and 0.15-0.20% of GNI for the least developed countries.

Only five countries met the UN's target for ODA: Luxembourg, Norway, Sweden, Denmark and the United Kingdom. According to the United Nations (https://developmentfinance.un.org/official-development-assistance), in 2019, ODA increased by 1.4%. However, it declined as a share of donor country GNI, from 0.31% to 0.30% on average, remaining far below the UN's recommended level.

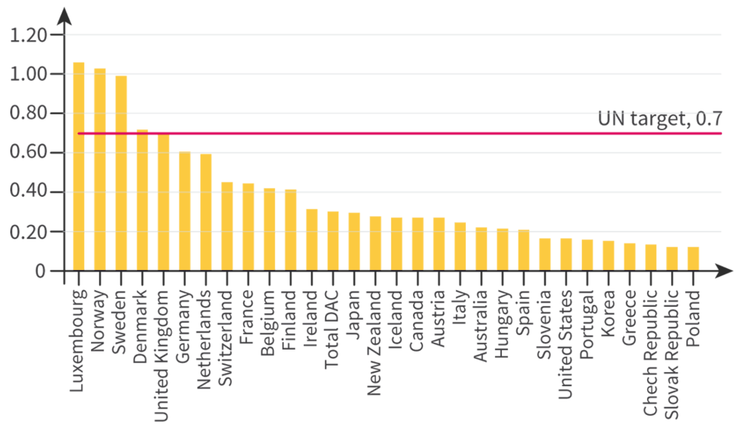

Figure 5: ODA as a percentage of GNI, 2019.

Source: "OECD (http://www.oecd.org/development/development-aid-drops-in-2018-especially-to-neediest-countries.htm)"

More information for figure 5

The bar chart displays the Official Development Assistance (ODA) as a percentage of Gross National Income (GNI) for various countries in 2019, along with the UN target. The x-axis lists countries such as Luxembourg, Norway, Sweden, Denmark, United Kingdom, and others. The y-axis shows percentages ranging from 0 to 1.20%.

Luxembourg, Norway, Sweden, Denmark, and the United Kingdom exceed the UN target of 0.7%, marked by a horizontal line on the chart. Luxembourg is the highest at over 1.0%, followed closely by Norway and Sweden. Other countries like Germany and Netherlands contribute around the 0.60% mark. The bar heights gradually decrease towards Poland, which has the lowest percentage at just above 0.0%.

The chart highlights countries meeting or exceeding the UN target with a distinct bar height above the reference line, illustrating the disparity between contributing countries.

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Non-governmental organisations (NGOs)

Non-governmental organisations (NGOs) are independent of government involvement. They are an important part of global partnerships for the SDGs, and play a key role in targeting certain issues and problems. Examples of well-known NGOs and their focus include:

- Transparency International – corruption
- Amnesty International – human rights
- Red Cross – humanitarian crises
- Médecins Sans Frontières – medical humanitarian assistance in crises
- Greenpeace – protection of the environment

Figure 4. Greenpeace ship Arctic Sunrise in the Helsinki, Finland harbour.

Student view

NGOs are unlikely to be able to make radical changes in the development landscape all on their own, due to their limited size and financial capacity. They often partner with national governments and other aid organisations, as well as each other, to achieve their aims. NGOs face a number of limitations that we will explore below. In addition to these limitations, NGOs have also been accused of having tunnel vision about their particular issue. They are not always willing or able to take the complex systems perspective necessary to fully understand a country's problems and how best to tackle them.

Strengths of development aid

A major benefit of development aid is that it can be targeted directly where it is needed. This could be in the industrial sector to promote economic diversification, or the financial or infrastructure sectors to make economic activity easier, or it could be directly involved with development of health, education or other merit goods important for human wellbeing. This means that economic growth and all three dimensions of human development can be achieved with development aid.

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Limitations of development aid

One issue with aid is similar to the problem of conditions, which you will learn about in section 4.10.9 (/study/app/pp/sid-186-cid-754025/book/multilateral-development-assistance-id-30690/). As well as tied aid, other forms of aid may also require recipient countries to take certain steps to meet the expectations of donors. This could be something minor, such as meeting visiting dignitaries from donor countries, or something more significant, such as having to take policy advice associated with how the aid money is spent.

A second related issue involves accountability. When a government uses tax money to support its citizens, it is clear that the government is accountable to the taxpayers and its own population. However, when a government is using aid money to support its people, accountability becomes more muddled. Is the government responsible for pleasing the donors or its own people? To what extent can it rely on local knowledge of the complex systems of the country to determine its own development path? This problem is compounded when multiple donors are involved, as is often the case. Angus Deaton, who won the Nobel Prize for Economics in 2015, makes the point about aid undermining democratic institutions in the video below.

Finally, aid money can be inefficient. Large organisations rely on hundreds, if not thousands of employees to execute aid programmes. Much of that aid money is spent on employing those working for aid agencies, rather than helping those on the ground. It can also be logistically difficult to get aid money to those who need it the most.

Student view

The provision of development aid to developing countries has increased dramatically since World War II. The effectiveness of development aid depends largely on the country's degree of self-determination of priorities and the use of its own infrastructure to deliver that aid. Without the first, a country will feel imposed upon and perhaps struggle politically. Without the latter, the country's own systems will never learn to improve or develop.

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Debt relief

Figure 5. Erasing debt can free up funds to support economic growth and development.

Credit: Getty Images yenwen

As you learned in section 4.9.5 (/study/app/pp/sid-186-cid-754025/book/economic-barriers-capital-flight-id-30584/), when debt levels become too high, individuals, firms and governments may not be able to make payments, called debt service, on the debt. When this occurs, we say that there has been a debt default. Debt restructuring is also possible if a country cannot service its debt. This is an extension of payments, a change in interest rate, or a reduction in the amount of a loan (called a 'haircut') to make it easier for the debtor country to manage the payments.

Debt relief/debt forgiveness is also possible and is considered a form of aid. This is where part or all of a country's debt is cancelled, rather than paid back. For several decades, the World Bank, together with the International Monetary Fund (IMF) and other international partners, has worked to reduce developing country debt in order to lower poverty and help achieve the SDGs.

Student view

This work falls into two broad categories: one for bilateral and multilateral debt and another for commercial debt. The Highly-indebted Poor Countries (HIPC) initiative (https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/11/Debt-Relief-Under-the-Heavily-Indebted-Poor-Countries-Initiative)provides debt forgiveness from some bilateral and multilateral debt for countries with the worst debt-to-GDP ratios. Another programme provides grant funding for some highly-indebted countries so that they can buy back the debts they owe to commercial creditors, at a steep discount.

Strengths of debt relief

There are a number of advantages of debt relief. Debt servicing entails a high opportunity cost, since money that services debt is not spent on increasing economic growth or development. Debt relief allows highly-indebted countries to direct their money to endeavours that really improve people's lives, such as improving education, health care and infrastructure.

Secondly, debt relief can improve intergenerational equity. Unsustainable debt is a burden taken on by leaders in previous years. They enjoyed the benefit of the new cash flows, but future generations may have less to spend on their development needs, especially if the money borrowed was not used for productive purposes.

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Limitations/disadvantages of debt relief

One argument against debt relief is called moral hazard. This is the idea that relieving debt sends a signal that countries do not need to avoid debt problems, because that debt will be cancelled anyway. This could result in continued problems with debt and irresponsible borrowing.

Another argument against debt relief is that future creditors may not be willing to lend or will demand a higher interest rate for their loans because they see a higher risk of non-payment. This will have a negative impact on future borrowers, who will have to pay more for their credit.

A third argument against debt relief is that if money is not repaid to creditors there is less money available to lend to others who may need it. In a sense, every unpaid dollar is money that could have been used for productive lending to another party.

Despite these concerns, the World Bank and the IMF see debt relief as an essential component of development strategies. The well-being of millions of people is threatened by the unsustainable debt levels of their countries. The intergenerational inequity caused by these debts must be alleviated. In addition, debt relief is a warning to irresponsible creditors, that they must lend carefully or they may face capital losses.

Figure 6. Children should not have to pay for their country's poor debt decisions.

Credit: Getty Images VikramRaghuvanshi

Student view

Theory of Knowledge

Foreign aid is an important development strategy to improve economic growth and development. However, it is not always effective.

Consider the claims made in the following TED Talk by Ernesto Sirolli on sustainable economic development and the issues surrounding its limitations.

Video 1. TED Talk by Ernesto Sirolli.

More information for video 1

- How important is perspective when examining the effectiveness of foreign aid and economic development? Consider Sirolli's claims of 'patronising' and 'paternalistic' perceptions of other cultures.
- Does the West suffer from cultural imperialism when it comes to development issues and aid? If so, what ways of knowing have been used to construct this perception?

Knowledge question: To what extent is recognition of another perspective essential in the acquisition of knowledge?

Complete section with 3 questions

Start questions

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Next section (/study/app/pp/sid-186-cid-7

Multilateral development assistance

Multilateral development assistance is the support provided by organisations that many countries contribute to. In terms of providing aid, the two most important organisations are the World Bank and the International Monetary Fund (IMF), based in Washington DC. Both institutions were founded at the Bretton Woods Conference (https://www.britannica.com/event/Bretton-Woods-Conference)at the end of World War II and they provide economic assistance to troubled countries. However, their objectives are different.

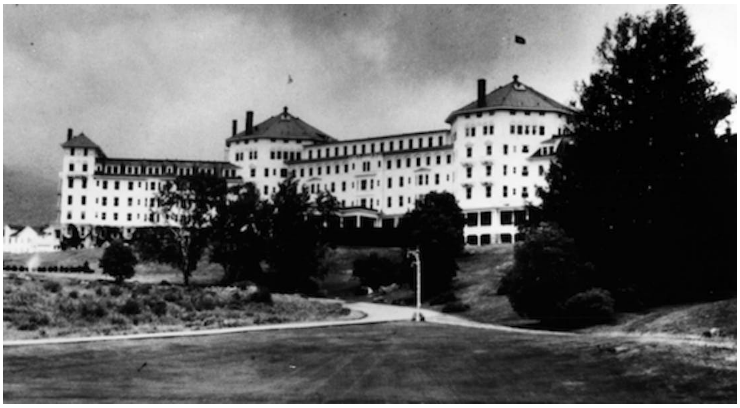

Figure 1. The Bretton Woods Conference in 1944 was the birth of the World Bank and the IMF.

Credit: TT.se akg-images

The IMF lends money to countries experiencing economic difficulties at a specific moment in time, particularly balance of payments and budget difficulties. The aim of the IMF is to maintain global economic stability.

The World Bank loans money for large-scale, long-term development projects. The aim of the World Bank is to reduce poverty.

Be aware

Students often confuse the IMF and the World Bank. Make sure that you know what each organisation's objectives are and what their lending is used for.

Both the IMF and the World Bank have been heavily involved in the economies of low-income countries over the past half century. Over that time, and particularly since the 1980s, these two institutions have become associated with a set of free-market-oriented policies that have been called the Washington Consensus (https://www.britannica.com/topic/Washington-consensus), a term first used by British economist John Williamson in 1989. He was referring to a set of ten policies that these institutions (both based in Washington, D.C.) seemed to agree was necessary to improve economic growth in Latin America. However, the term was later used to refer to the two institutions' bias towards neoliberal, free-market-oriented policy prescriptions, which have been widely criticised.

Countries who needed to access funds from both organisations were, and to some degree still are, often asked to enact market-based, supply-side policies to increase growth. These were known as structural adjustment programmes (SAPs). Though these policies had some positive effects on the economies that adopted them, they also sometimes caused

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significant harm to vulnerable groups in these countries.

Most recently, both the IMF and the World Bank have been working to develop a more nuanced, contextual approach to maintaining global economic stability and development; one that recognises the important role of the environment, society, institutions, and the state, in addition to markets and the economy. There is now a greater understanding of the complex systems involved in economic growth and development.

The World Bank

The World Bank, which began operations in 1946, consists of two separate divisions: the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). There are 189 country members of the IBRD and 173 country members of the IDA. The World Bank is a major source of financial and technical help to developing countries. The World Bank establishes partnerships with the countries it lends to, with the aim of reducing poverty and promoting development.

One service the World Bank provides is low-interest loans and grants to developing countries. Countries use these funds for education, health, public administration, financial and private sector development, agriculture, infrastructure and natural resource management. The World Bank often partners with the recipient government and other multilateral institutions, private sector investors and commercial banks.

Student view

Figure 2. The World Bank in Washington, DC.

Credit: Getty Images uschools

On the World Bank website (https://projects.worldbank.org/), you can find a list of recently approved projects. One project that was approved in May 2020 was USD 100 million to expand electricity services in Rwanda. This is related to an issue highlighted in the worked example in section 4.10.4 (/study/app/pp/sid-186-cid-754025/book/marketbased-policies-id-30684/) for the World Bank's *Doing Business* report for Rwanda. One area where the country has been falling short is the ease of accessing electricity. This loan should help improve this important part of the country's infrastructure. In fact the World Bank is an important partner for many developing countries in infrastructure investments.

Another service that the World Bank provides is policy advice, research and technical assistance to support the Bank's and developing countries' own investments. In addition to the research that supports particular initiatives, the World Bank also hosts and co-sponsors conferences and forums on development issues. It provides multiple databases, some of which you may even have used in this course.

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World Bank financing and technical help improve the quality and quantity of factors of production in developing countries around the world. The organisation is therefore an important part of increasing long-run aggregate supply and potential output. This can result in higher incomes, which will improve the material dimension of development. The World Bank's role in improving education, health care and infrastructure provision should also play an important role in improving the relational dimension by providing greater freedoms, capabilities, and improved human networks for people to achieve their aims in life. The subjective dimension of development should also advance with such provisions, as greater access to education, better health care and expanded infrastructure should all improve people's feelings and perceptions about their lives.

The International Monetary Fund

The International Monetary Fund (IMF) ensures the stability of the international monetary system. This includes the exchange rate system and the international payments systems that enable people to make economic transactions with one another. The IMF also promotes sustainable economic growth, high employment and reduced poverty, which are all important factors for global financial stability.

The IMF pursues its objectives in three main ways:

- Economic surveillance – The IMF keeps track of economic changes and conditions, as well as economic and financial policies, in the economies of its 189 member countries. It monitors possible risks and makes policy recommendations to support stability.
- Lending – The IMF makes loans to member countries when they have balance of payments problems (or are at risk of such problems). This money helps them to rebuild their international reserves, pay for imports and stabilise their currencies. This lending should help provide the conditions to support economic growth.
- Capacity development – The IMF supports countries around the world with technical expertise and advice to help them improve both their institutions and their economic policies.

The video below explains how the IMF provided technical support and expertise to Colombia when oil prices declined in 2014, threatening Colombia's tax base and government tax revenues. The IMF advised on how to use tax reforms to prevent a budget crisis and to promote financial stability into the future.

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view

Video 1. A Tax Reform Succeeds in Colombia

More information for video 1

Receiving a loan from the IMF is always conditional. The IMF requires that countries make reforms to solve their current economic problems and put the economy on a more sustainable path to growth. As mentioned at the beginning of this section, these policies used to focus on market-based, supply-side policies, known as structural adjustment programmes

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(SAPs), including:

- reducing government spending and improving tax collection
- trade liberalisation and export promotion
- devaluation of currency
- removal of price controls
- privatisation and deregulation
- improved governance

However, in recent years, there has been greater awareness of the need for strong institutions and the appropriate role of governments in fostering development and improving equity. The IMF has worked hard to ensure that policies are now contextual rather than knee-jerk pro-market mandates.

Even Joseph Stiglitz, former head of the World Bank and a prominent critic of the IMF, has commented on the positive change in the IMF (https://www.economist.com/finance-and-economics/2020/04/08/joe-stiglitz-and-the-imf-have-warmed-to-each-other). The transformation seems to have begun under the leadership of Dominique Strauss-Kahn. He became the IMF managing director around the start of the 2007 financial crisis, and advocated fiscal stimulus, not austerity. The change in the IMF continued under the leadership of Christine Lagarde from 2011–2019, who placed a special focus on inequality, climate change and the groups that globalisation made vulnerable. The current managing director of the IMF, Kristalina Georgieva, and chief economist Gita Gopinath appear set to continue with these nuanced policies, which will be important to deal with the financial crisis posed by the COVID-19 pandemic.

Figure 3a. The current Managing Director of the IMF Kristalina Georgieva.

Credit: Getty Images Sean Gallup / Staff

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Figure 3b. Chief Economist Gita Gopinath.

Source: "Gita Gopinaph (https://commons.wikimedia.org/wiki/File:Gita_Gopinaph.jpg)" by Cuidro is licensed under

Activity

Not Your Grandmother's IMF — Freakonomics podcast

Christine Lagarde was the chair and managing director of the IMF from 2011—2019. During her time at the IMF, she emphasised climate change, inequality and helping stakeholders that have been harmed by globalisation. She can be seen as a pivotal figure for engaging the IMF in complex systems and openness to more nuanced policies beyond the Washington Consensus.

In the Freakonomics podcast Not Your Grandmother's IMF (https://freakonomics.com/podcast/not-grandmothers-m-f/), she talks about her work and the role of the IMF in the global economy. She also discusses the tensions between the IMF and countries regarding the prescriptions to improve the economy. She also discusses the important qualities of women in leadership.

Why is it important that multilateral institutions like the IMF and World Bank consider both market-based and interventionist strategies to improve the economic performance of countries in need?

Figure 4. Christine Lagarde, former chair and managing director of the IMF.
Credit: Getty Images Thomas Lohnes / Stringer

Activity

If you created a summary table about the strengths and limitations of the previous strategies, add assistance from the World Bank and IMF to the table as well.

Complete section with 3 questions

Start questions

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Institutional change: banking and microcredit

Figure 1. Institutional change requires thinking about complex systems.

Credit: Getty Images pagadesign

Improved access to banking, including microfinance and mobile banking

As you learned in section 4.9.9 (/study/app/pp/sid-186-cid-754025/book/institutional-barriers-tax-id-30594/), a lack of access to banking and credit is a barrier to development. It limits the ability of the poor to save and receive income, apply for credit, and acquire insurance. Lack of access to banking makes the poor financially vulnerable.

Improving access to transaction accounts

Countries can take a number of steps to improve financial inclusion in their populations. Promoting financial education in the population is important so that people understand how they can benefit from banking services and how to access and use them. Consumer protection is also critical to ensure that people have confidence in banking institutions and do not risk losing their assets when using banking services.

According to the World Bank, an important first step is to increase access to a transaction account. This is a basic bank account that allows people to store money, send and receive payments. A transaction account is considered the entry point for individuals and firms to gain access to other financial services, such as credit, insurance and pension funds. To increase the number of people with an account, countries have:

- increased the number of bank access points, especially in rural areas
- reduced service fees for bank accounts
- helped people get biometric identification to prove identity
- increased the use of digital technologies

Mobile banking

Digital technology is particularly important. The video below shows the role it has played recently to improve access to financial services for the world's poorest.

The Global Findex Database 2017: Measuring Financial Inclusion and the

Widespread access to mobile phone technologies has changed how people store and exchange money. In low-income countries mobile payments are now a common transaction method. This is one reason why the United Nations Human Development Report 2019 (http://www.hdr.undp.org/en/2019-report) describes mobile phone technology as a necessity for 'basic' capabilities. This was discussed in section 4.8.4 (/study/app/pp/sid-186-cid-754025/book/single-indicators-economicsocial-inequality-id-30575/).

Case study

M-Pesa, Africa's most successful mobile money service

Figure 2. M-Pesa kiosk in Nairobi, Kenya.

Source: "M-Pesa Kenyan Kiosk (https://commons.wikimedia.org/wiki/File:M-Pesa_Kenyan_Kiosk.JPG)" by RealtOn12 is licensed under CC BY-SA 3.0 (https://creativecommons.org/licenses/by-sa/3.0/deed.en)

M-Pesa (https://www.vodafone.com/what-we-do/services/m-pesa) was established in 2007 by Vodafone's associate in Kenya, Safaricom, and now operates in 7 countries: Kenya, Ghana, Egypt, Democratic Republic of Congo, Lesotho, Mozambique and Tanzania.

M-Pesa provides financial services to more than 37 million people who have no access to formal banking services. Through the M-Pesa mobile app, people can safely, securely and affordably send and receive money, pay bills, make stock purchases, receive income and get short-term credit, among other services.

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M-Pesa works through a network of authorised agents, who accept cash in exchange for digital money that can be transferred easily to others. The recipient receives the electronic money and can then redeem it for cash at a local agent.

M-Pesa services also reduce theft in cash-based markets and provide accurate record-keeping of transactions, helping to improve tax compliance. M-Pesa also facilitates transfer payments from governments and nongovernmental organisations, helping some of the world's poorest receive the financial support they need.

Use an appropriate diagram (AD/AS or poverty trap) to explain how cash transfers via mobile phone can improve economic growth and development for the world's poorest.

Microcredit

The global poor also have low access to credit, as you learned in section 4.9.9 (/study/app/pp/sid-186-cid-754025/book/institutional-barriers-tax-id-30594/). Even when there is great entrepreneurial spirit, it can be very difficult for those in poverty to start a business if they do not have access to credit .

Microfinance is a way to provide individuals and businesses with all kinds of financial services. Microcredit is a subset of microfinance that specifically refers to small loans for people to start up or continue to finance a small-scale business, such as bicycle repair services, woodworking, sewing and knitting workshops, kiosks, and so on. Often these loans are targeted at women to improve their financial independence and empowerment. Usually they do not require collateral or a credit history, but they often rely on small groups of borrowers in a community to support one another should one of them face financial difficulties with their loan.

Figure 3. Microcredit can help entrepreneurs start their own business.

Credit: Getty Images Trevor Williams

Student view

Microcredit has expanded rapidly in the last twenty years. There are now hundreds of millions of people who have taken microloans. There has been enormous enthusiasm for microcredit as a strategy to improve economic growth and development. The 2006 Nobel Peace Prize was awarded to Mohammed Yunus and the Grameen Bank (http://www.grameen.com/) for their role in the reduction of world poverty. Anecdotal evidence and the poverty trap theory you learned in section 4.9.1 (/study/app/pp/sid-186-cid-754025/book/poverty-traps-poverty-cycles-id-30581/) suggests that microcredit should start virtuous positive feedback loops that break the poverty trap associated with being poor.

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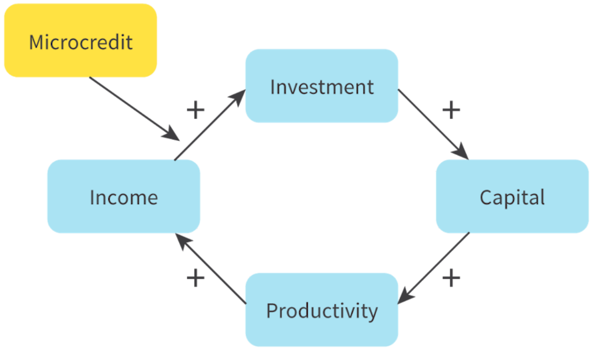

Figure 4. Microcredit can start virtuous positive feedback loops for individuals and small businesses.

More information for figure 4

The flowchart illustrates a cycle starting with Microcredit, which leads to Investment. This investment is shown to increase Capital, which enhances Productivity. Improved productivity subsequently raises Income, which can then be reinvested back into the system, creating a positive feedback loop represented by arrows. Each element (Microcredit, Investment, Capital, Productivity, Income) is enclosed in a rectangular box connected by arrows indicating the flow and influence among them. The arrows are labeled with plus signs, suggesting the positive impact of each step on the next.

[Generated by AI]

There is a growing body of empirical research showing that the impact of microcredit on poverty is more limited than once thought. First of all, an assumption behind microfinance is that the poor are natural-born entrepreneurs. This assumption seems to be backed by the fact that a large percentage of the poor manage some kind of non-agricultural business endeavour, despite the high costs and hardships of doing so.

However, as Banerjee and Duflo point out in *Poor Economics*, many of those running their own businesses are doing so not because they are natural entrepreneurs, but because they have no other option to earn income. According to the authors, many of the poor aspire to having a secure job employed by someone else; in fact, the government is the preferred employer. Thus, they are reluctant entrepreneurs and because of this, their businesses tend to remain small, perhaps helping out individual families or a few members of the immediate community, but not growing to the size that would employ many people and lift many out of poverty.

Student
view

Figure 5. Many businesses receiving microcredit remain small.

Credit: Getty Images Thomas Barwick

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Secondly, one reason why microcredit institutions are able to offer lower interest rates than other non-institutional money lenders in poor countries is that they have very rigid rules on borrowed amounts and the repayment schedule, which often starts one week after the loan is made. These rules make accounting easy and quick for the lender, keeping the lender's costs low. However, for many borrowers, the rules are not flexible enough for their situations, which may involve a longer time horizon for initial payments. As a result they continue to borrow from other non-traditional lenders at higher rates of interest. As Banerjee and Duflo point out, there seems to be a tension between entrepreneurship that naturally involves risks and the spirit of microcredit. In a sense microcredit is set up to be intolerant of failure, and therefore it does not always foster the risk-taking enterprise that could be truly transformational.

It is worth noting that Banerjee and Duflo's research into microcredit was conducted using randomised control trials. This research strategy randomly allocates subjects to two or more groups (an experimental group and a control group), treats them differently, and then compares them according to some measure.

This research strategy allowed Banerjee and Duflo to move beyond theory and anecdotes to scientifically explore the impact of microcredit on consumer spending, health, education, and women's empowerment. This research showed that microcredit does enable more individuals to start businesses, but their research indicates that it has little impact (https://economics.mit.edu/files/5993) on broader development measures. Such empirical research is vitally important in economics to determine what strategies actually work, so that economists are not relying only on theory and anecdote with their policy recommendations.

Activity

If you created a summary table about the strengths and limitations of the previous strategies, add microcredit to the table as well.

Complete section with 3 questions

Start questions

Student view

Previous section(/study/app/pp/sid-186-cid-754025/book/multilateral-development-assistance-id-30690/) Next section (/study/app/pp/sid-186-ci

Institutional change: women's empowerment, corruption, property/land rights

Increasing women's empowerment

As you learned in section 4.9.10 (/study/app/pp/sid-186-cid-754025/book/sociocultural-barriers-id-30589/), gender inequality is a major problem for development worldwide, both in developed and developing countries. Gender inequalities limit women's access to educational attainment, economic opportunity, and political empowerment and representation. Mental models of gender bias are pervasive. They are held by both men and women worldwide and are difficult to combat. Gender inequality is a consequence of the interaction of complex systems and, as such, it requires thoughtful analysis of the barriers and opportunities for women in myriad contexts.

Figure 1. Empowering women is a force for economic growth and development.

Credit: Getty Images Vladimir Vladimirov

The United Nations Secretary General's High Level Panel on Women's Empowerment has identified seven drivers of positive change. For each of the drivers, the UN Panel identified the recommendations listed in **Table 1** below.

Table 1. Drivers of women's empowerment and recommendations.

Driver 1: Tackling adverse norms and promoting positive role models	1. Eliminate, prevent and respond to all forms of violence against women and girls. 2. End gender discrimination and change stereotypes gendering roles and abilities. 3. Eradicate the stigmatisation of informal workers and support their organisations.

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Driver 2: Ensuring legal protection and reforming discriminatory laws and regulations	1. Reform laws discriminating against women and enact legislation enabling gender equality. 2. Expand social protection coverage for all. 3. Create an enabling legal environment for informal workers. 4. Increase women's access to justice, legal awareness and legal aid.
Driver 3: Recognising, reducing and redistributing unpaid work and care	1. Recognise, redistribute and reduce care work. 2. Ensure decent work for paid care workers, including migrant workers. 3. Foster social norm change to redistribute care from women to men and ensure that care is their equal right and responsibility.
Driver 4: Building assets — Digital, financial and property	1. Ensure women's equal access to and control over productive resources, including land, labour and capital. 2. Encourage stakeholders of a country to assess how women are progressing along the digital inclusion continuum. 3. Enable women's voice to shape digital, financial and property products, services and policies.
Driver 5: Changing business culture and practice	1. Conduct an internal self-audit (on pay, employment, leadership, CSR and supplier engagement). 2. Incentivise frontline management to set and meet targets for gender inclusion. 3. Set procurement targets for sourcing from women-owned enterprises. 4. Map value chains to ensure ethical sourcing and workers' rights.
Driver 6: Improving public sector practices in employment and procurement	1. Promote gender equality in public sector employment by establishing gender targets or quotas for hiring and measuring progress. 2. Promote women-owned enterprises and women's collectives by considering establishing and tracking government-wide targets for women's participation in procurements. 3. Provide support for informal and agricultural workers by reforming procurement laws and regulations to allow collective enterprises to bid on public procurements.
Driver 7: Strengthening visibility, collective voice and representation	1. Ratify and implement ILO Freedom of Association and Protection of the Right to Organise Convention, 1948 (No. 87), and Right to Organise and Collective Bargaining Convention, 1949 (No. 98). 2. Reform legal frameworks to protect informal workers and promote the formalisation of their work in line with ILO Recommendation No. 204.

Student
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Activity

Table 1 has a list of recommendations to improve women's empowerment in seven key areas. However, the recommendations are not very specific.

Select one recommendation for each of the seven drivers of women's empowerment. Brainstorm (alone or with a partner) a concrete action or a specific measurement target that governments or organisations could take to fulfil that recommendation.

As an alternative you can access the SDG 5 indicators (https://sdg-tracker.org/gender-equality)to get some ideas.

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Reducing corruption

In section 4.9.7 (/study/app/pp/sid-186-cid-754025/book/political-barriers-id-30586/), you learned about the role of corruption as a barrier to development, particularly with regard to undermining the good governance that is so important to fostering economic growth and development.

Transparency International outlines five critical steps to reduce corruption:

- enforce and prosecute corruption through separate law enforcement branches and an effective court system, as well as a strong legal framework
- reform public administration and finance management by strengthening the role of auditing agencies and requiring disclosure of budget information
- promote transparency and access to information through government openness and freedom of the press
- empower citizens through community monitoring initiatives to help detect corruption
- close international loopholes in the law that enable corrupt officials to hide their financial gains offshore

These measures can be very difficult to implement in countries where corruption is the established norm. Complex systems perpetuate corruption. According to the OECD (https://oecdobserver.org/news/archivestory.php/aid/291/Fighting_corruption_in_the_developing_countries.html), poverty and low levels of development perpetuate corruption in a number of ways, despite efforts to combat it. For example, low wages in government jobs encourage people to seek extra income through corrupt activities. A small supply of public services relative to demand creates opportunities for corruption. Low levels of education mean that many people are not aware of their rights, creating the opportunity for abuse. It is clear that, as with all development strategies, there is no easy fix to this systemic problem.

Property rights / land rights

In section 4.9.8 (/study/app/pp/sid-186-cid-754025/book/legal-systems-and-property-rights-id-30588/), you learned about what property/land rights are and the problems that are associated with the lack of these rights. The government plays a key role in defining and enforcing both formal and informal property rights. Housing and land rights are particularly important.

Student view

Housing is considered a fundamental human right. The goal of SDG 11.1 (Sustainable Cities and Communities) is that by 2030, everyone will have access to adequate, safe and affordable housing and basic services, and slums will have been upgraded. In many countries around the world, the poor have no clear ownership of their housing. This makes them vulnerable if it is threatened by government seizure, demolition or expropriation by other parties. According to the United Nations (https://www.ohchr.org/Documents/Issues/Housing/InformalSettlements/UNHABITAT_HumanRights-BasedApproch.pdf), two million people are forcibly evicted from their housing every year. Insecure housing rights are a contributing factor to the persistence of inadequate housing. Governments have recognised the importance of housing to the material, relational and subjective dimensions of development, and have taken steps to improve housing rights.

One step is to formally recognise ownership of housing where poor people already reside (see case study below). Policies granting housing/property rights to slum dwellers reduce their vulnerability to harassment and forced eviction, provide them with collateral to secure credit, enable them to invest in improvements to their living space, and reduce insecurity about the future. They can also increase the labour supply of adults and reduce child labour. If a family does not officially own their housing or the land it is on, an adult has to remain at home during the day to guard it and cannot go out to earn a wage. Instead children may be sent out to work. This is an interesting example of the complex web of economic impacts of government policy.

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Case study

India grants slum-dwellers property rights

Figure 2. Formal property rights will be granted to the inhabitants of informal settlements in New Delhi.
Credit: Getty Images picturetravels

At the end of 2019, India's government legalised more than 2 000 informal settlements in New Delhi, giving around 4 million inhabitants property rights that would enable them to build and sell properties and take loans. In addition to removing the constant fear of eviction for the inhabitants. The hope is that these rights will incentivise the property owners to make investments in safe housing structures, and substantially improve the quality of life in these settlements.

Explain how granting formal property rights to inhabitants of informal settlements or slums can drive economic growth and development.

Read more (https://www.reuters.com/article/us-india-slums-housing/india-slum-dwellers-win-property-rights-thousands-left-out-idUSKBN1Y91OK)

Student view

Another step is to ensure that women are able to inherit land upon the death of a relative, and to have property rights in cases of divorce. Some countries do not secure these rights for women. Without these property rights, women are forever dependent on spouses or relatives for their housing arrangements. This creates hardship and vulnerability that contributes to inequity. A further step that governments can take is to enforce the laws that guarantee equal property rights to women.

Another important area is land rights, also known as land tenure. Clarifying and strengthening land tenure is important for securing the productive assets of the poor. Land is an important resource for food production for many of the world's poor, both for their own families and for selling surpluses to earn income. Increasing land ownership can be an effective way to increase incomes and wealth among the world's poor.

For example, Kerala, the Indian state you encountered earlier in section 4.10.6 (/study/app/pp/sid-186-cid-754025/book/interventionist-policies-merit-goods-id-30686/), has used land reform to improve equity. The state has legislation that caps how much land a family can own and increases land ownership among tenant farmers, who work the land but do not own it. Another strategy is for local governments to use new digital technologies to map, manage and document land rights and administration.

As with all laws, governments must enforce property rights and land tenure. Laws mean little if the people they are meant to help cannot exercise their rights, or if it is too expensive to do so in a court. Unfortunately, this is still often the case, even where progress has been made on establishing property rights in law.

Activity

If you created a summary table about the strengths and limitations of the previous strategies, add increasing women’s empowerment, reducing corruption and property rights/land rights to the table as well.