Yr 13 Economics

Theme 4: A global perspective

Section 4.3: Emerging and developing economies

4.3.3 Strategies influencing growth and development – Part 2

- Interventionist strategies:
  - Development of human capital
  - Protectionism
  - Managed exchange rates
  - Infrastructure development
  - Promoting joint ventures with global companies
  - Buffer stock schemes

The specification:

- Theme 4 – A global perspective
  - Emerging and developing economies

Subject content	What students need to learn:
4.3.3 Strategies influencing growth and development	a) Market-orientated strategies: o trade liberalisation o promotion of FDI o removal of government subsidies o floating exchange rate systems o microfinance schemes o privatisation b) Interventionist strategies: o development of human capital o protectionism o managed exchange rates o infrastructure development o promoting joint ventures with global companies o buffer stock schemes c) Other strategies: o industrialisation: the Lewis model o development of tourism o development of primary industries o Fairtrade schemes o aid o debt relief d) Awareness of the role of international institutions and non-government organisations (NGOs): o World Bank o International Monetary Fund (IMF) o NGOs

Interventionist strategies

Interventionist strategies rely upon governments to regulate and manipulate markets, or bypass markets entirely through direct provision of goods and services

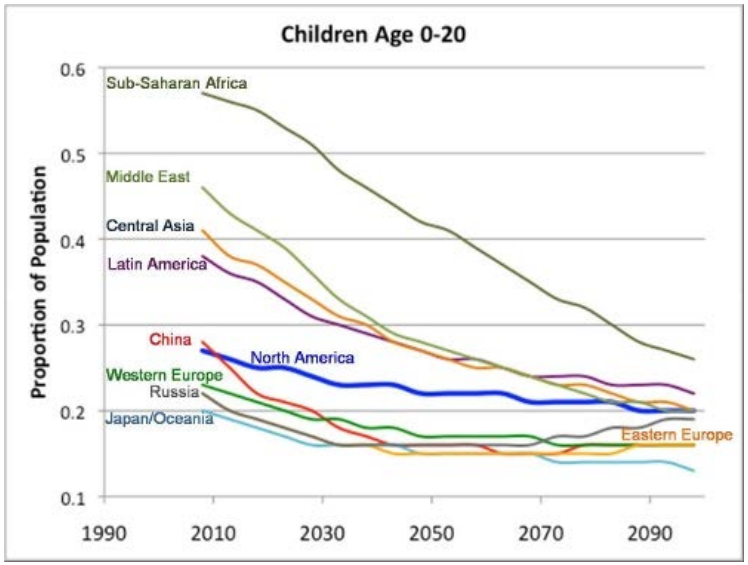
- **Development of human capital**
  - Investing in education and skills
    - Raising life expectancy; gender issues
- **Protectionism**
  - Imposing tariffs and non-tariff barriers to protect domestic firms
    - Anti-dumping
- **Managed exchange rates**
  - Keeping the value of the currency low to help the BoP
    - Reducing currency volatility
- **Infrastructure development**
  - Increasing the productive capacity of the economy
    - Boosting Aggregate Demand
- **Promoting joint ventures (JVs) with global companies**
  - Reducing MNC exploitation
    - Transfer of knowledge and skills
- **Buffer stock schemes**
  - Reducing commodity price volatility
    - Incentive for long-term planning

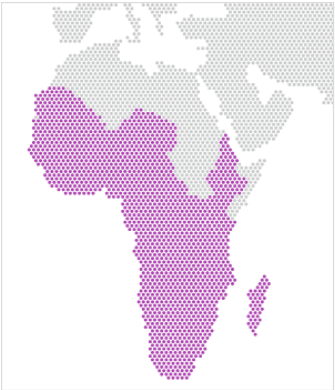
Development of human capital

Population growth

The changing structure of the population and its rate of growth is important for development. The lower the level of development, the higher the birth rate

- A high birth rate is problematic for developing countries
  - Increased dependency ratio
    - More non-productive members of the population dependent on the earnings of the productive members of the population
  - More babies to feed, clothe, educate etc
    - Increased pressure on social infrastructure (schools, hospitals, housing etc)





Sub-Saharan Africa (2013)

24.7 million people living with HIV

4.7% adult HIV prevalence

1.5 million new HIV infections

1.1 million AIDS-related deaths

39% adults on antiretroviral treatment

Source: UNAIDS Gap Report 2014

- In many countries, AIDS is wiping out a generation of adults
  - This is further worsening the dependency ratio

Population issues

Uganda

Age structure

0-14 years: 50%
15-64 years: 47.9%
65 years and over: 2.1%

Median age: 15 years

Population growth rate: 2.692%

Birth rate: 47.84 births/1,000

Death rate: 12.09 deaths/1,000

Infant mortality: 64.82 /1,000 live births

Life expectancy at birth: 52.72 years

HIV/AIDS - adult prevalence rate: 5.4%

HIV/AIDS - people living with it: 940,000

United Kingdom

Age structure

0-14 years: 16.7%
15-64 years: 67.1%
65 years and over: 16.2%

Median age: 40.2 years

Population growth rate: 0.279%

Birth rate: 10.65 births/1,000

Death rate: 10.02 deaths/1,000

Infant mortality rate: 4.85 /1,000 live births

Life expectancy at birth: 79.01 years

HIV/AIDS - adult prevalence rate: 0.2%

HIV/AIDS - people living with it: 77,000

Development of human capital

Developing countries have to slow down population growth to match economic growth. They also need to make better use of their existing adult human capital

- Possible policies include:
  - Education programmes
  - Family planning clinics
  - Disincentives to have children (e.g. China)

  - State pensions
    - Children then are no longer required to provide food for aged parents

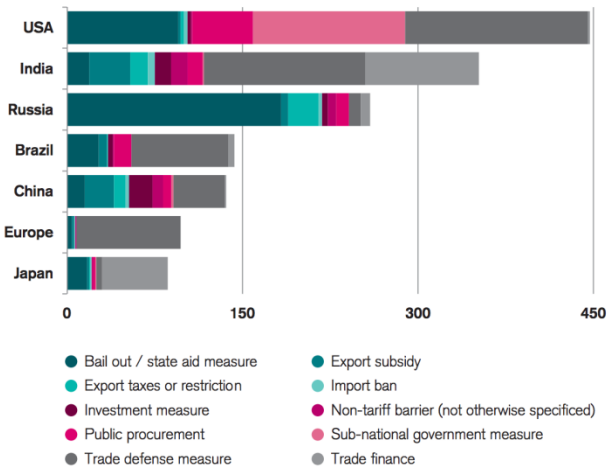
- Improving the status of women
  - If women are under-utilised in the workforce, GDP growth is negatively affected
    - The more educated the mother, the more likely her children will achieve a better education

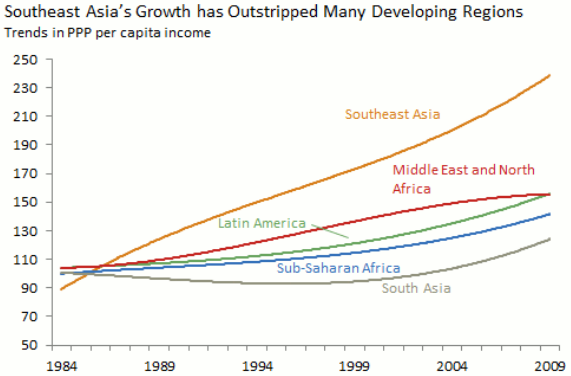
Protectionism

Protectionism and import substitution

Protectionism means trying to protect an economy from the full impact of free trade. Governments try to replace imported goods with domestically produced ones.

- Protectionist measures used by government include:
  - Tariffs (import duties) – taxes on imported goods
  - Quotas – limits on the volume imports allowed
  - Voluntary export restraint agreements with other countries
  - Embargoes – a total ban on imported goods
  - "Non-tariff barriers" – administrative obstacles, like over-lengthy customs inspections
  - Export subsidies – payments by government to exporters to lower their cost





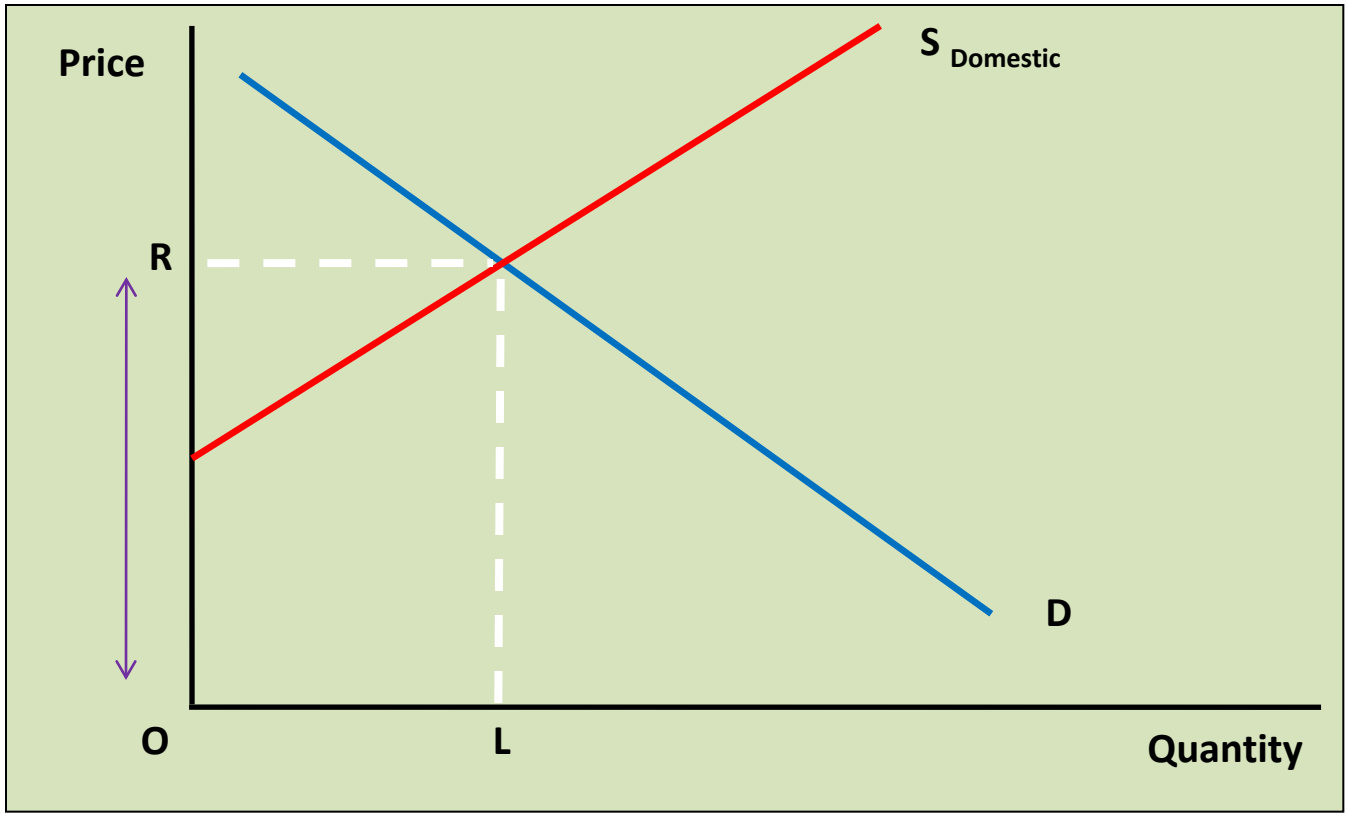
- Import substitution is the opposite policy to export-led growth, which was used successfully by the "Asian Tiger" economies
  - The Asian Tigers believed that by integrating with the global trading system, their domestic industries would be forced to become dynamically efficient and develop specialisation
    - They argue that protected domestic producers have no incentive to reduce costs or improve products

Why restrict free trade?

There are a number of reasons why a country might wish to restrict its trade…

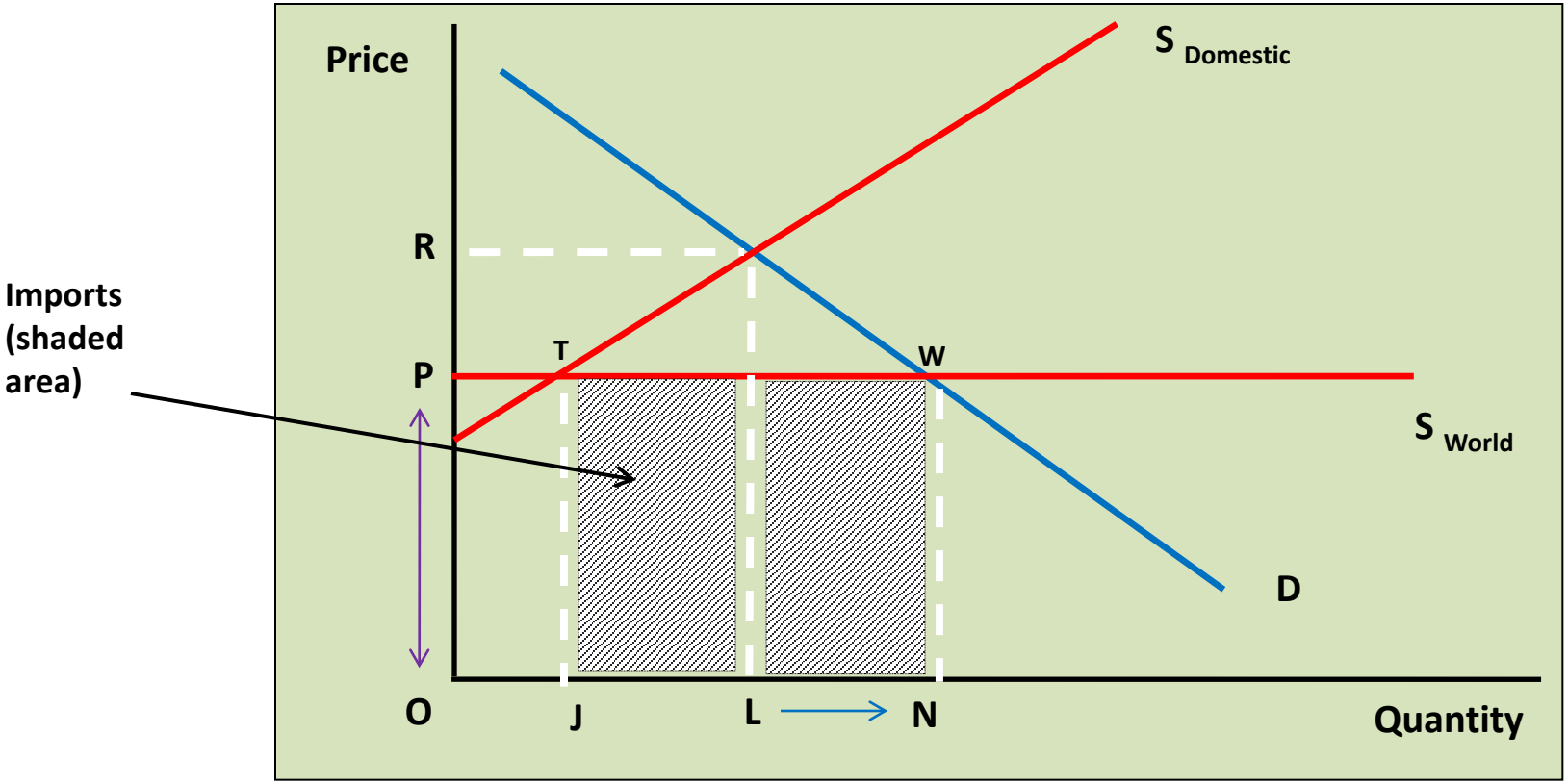
- Balance of payments rationale
  - Desire to control the growth of imports to achieve balance of payments equilibrium
- Comparative Advantage
  - Desire to protect infant industries until they have achieved the economies of scale to compete globally
- Response to 'dumping'
  - Dumping is predatory pricing by an overseas producer, off-loading of excess capacity at cut price
- Fear of structural unemployment if/when industries are destroyed by international trade
  - Immobility of labour and capital; social costs of unemployment.
- Potential loss of governmental revenue
  - Gov't depends on tariffs and duties
    - This is particularly the case in developing nations
- Anti-"globalisation"
  - Free trade is seen by some countries as the back door for economic colonisation
    - Fear of Multi-National Corporations

Impact of tariffs on a domestic market 1



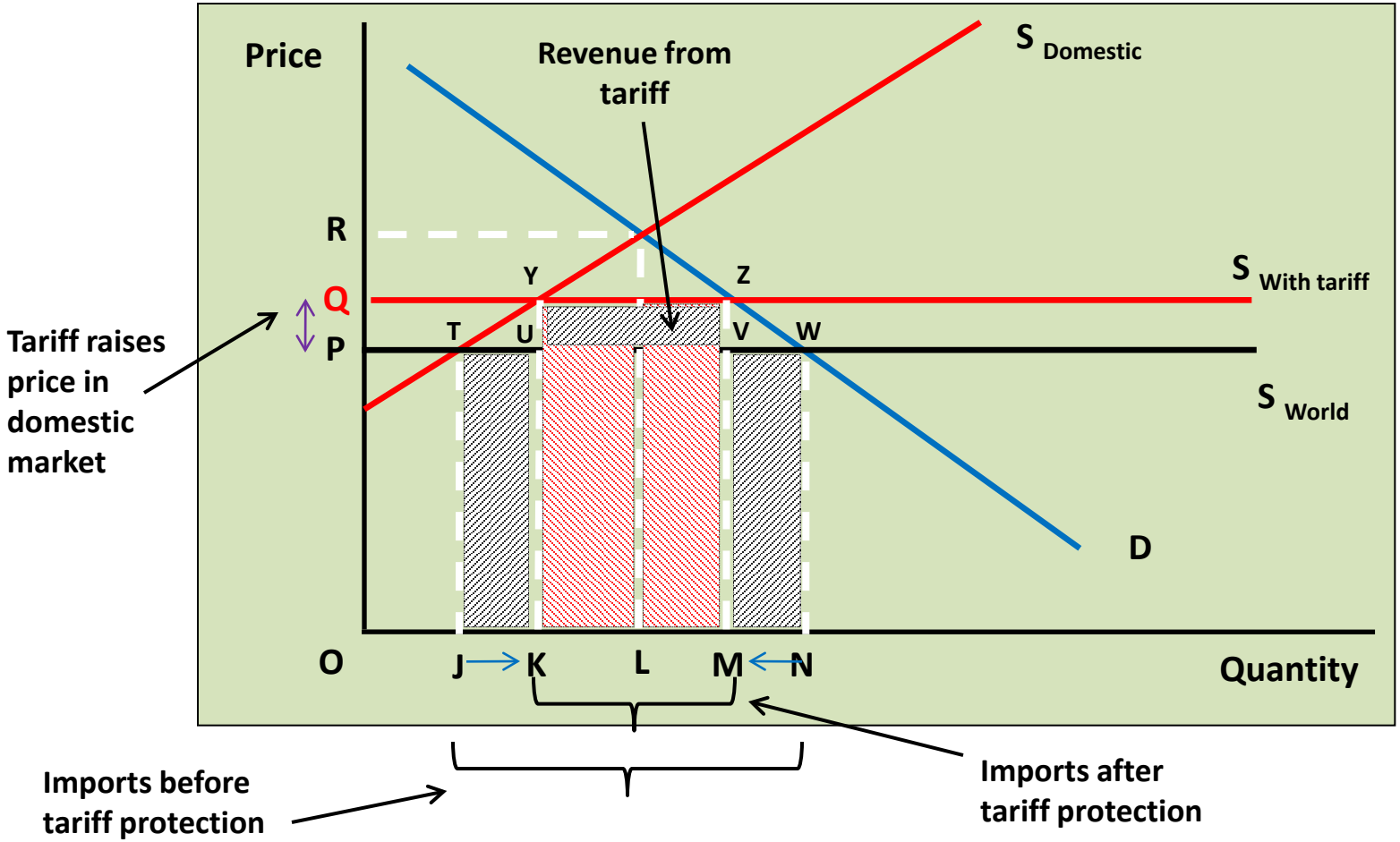
For any good, in a market where there are no imports, $S_{domestic}$ is the supply curve, O ⟷ R is the equilibrium price, and L is the quantity of domestic consumption at the price R

Impact of tariffs on a domestic market 2



If a country is free to import a given good, and the world price of that good is O ⟷ P, the supply curve becomes S_{world} and domestic consumption increases from L ⟶ N

Impact of tariffs on a domestic market 3

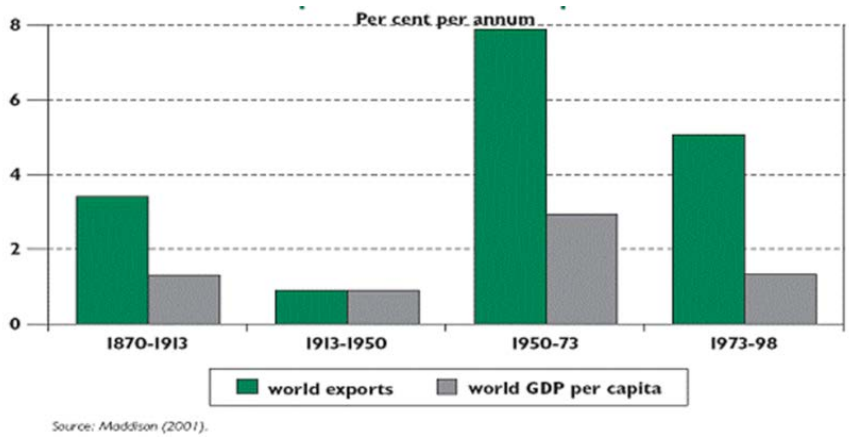


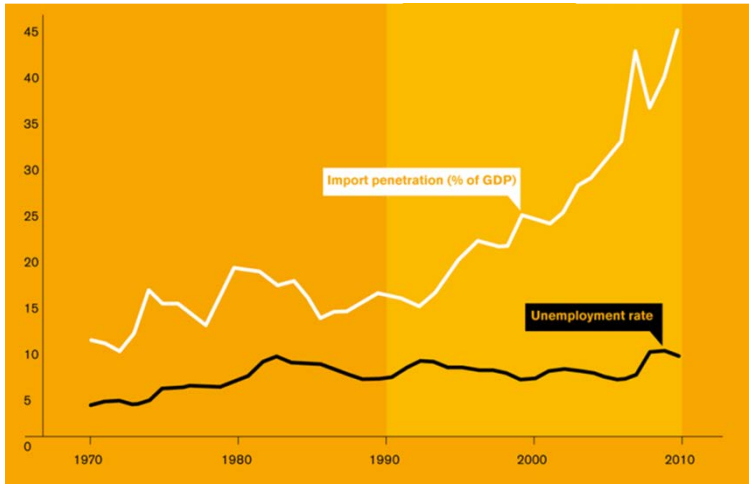
If the country then imposes a tariff, P ⟷ Q to protect its domestic producers, the supply curve will shift upwards to $S_{\text{With tariff}}$. Domestic consumption will fall by MN, while domestic production will rise by JK. Imports will fall from JN to KM.

Outward-looking strategies

Not all countries go through the import substitution stage. Many countries seek export-led growth from the outset but are willing to accept imports too

- ❑ Export promotion seeks growth through international linkages
- ❑ Outward-looking governments are likely to favour an "open economy". This will involve:





Critics of free trade argue that imports destroy local jobs. Data from 23 countries show that since 1990, any link between imports and the unemployment rate has disappeared. Source: WTO

- ➢ Dismantling of protective tariff barriers
- ➢ Removal of obstacles to mobility of labour
- ➢ Openness to MNC inward investment

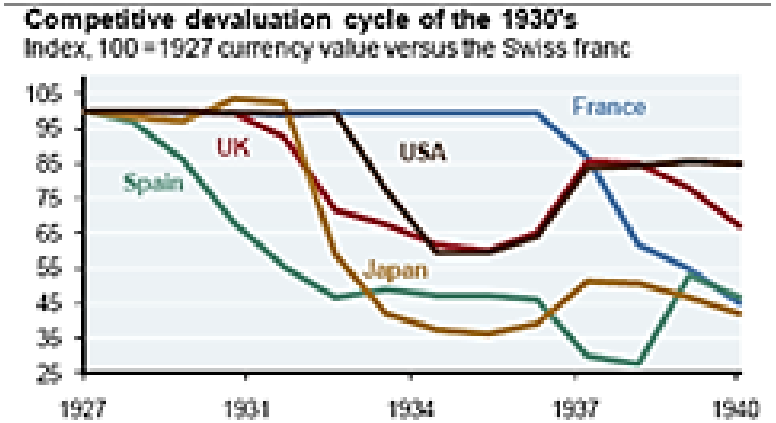
- ❑ Outward-looking economies can gain access to:
  - ➢ New sources of investment
  - ➢ Access to global markets
  - ➢ Economies of scale

Managed exchange rates

Reducing exchange rate volatility

Governments will sometime choose to manage their country's exchange rate to reduce volatility for exporters and importers, which makes it difficult to plan ahead

- Exchange rate volatility makes it difficult for exporters and importers to make decisions about the future
  - If they know that their currency will only fluctuate within a narrow band against the currencies of their major trading partners, firms can order ahead with confidence
    - A managed currency can also prevent sharp appreciation, which can harm employment through lower export growth

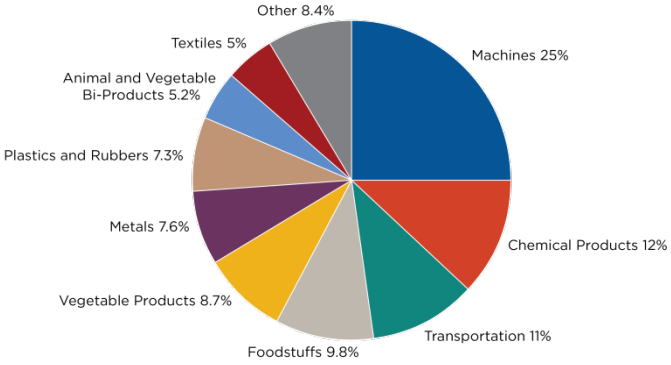


In the 1930's, Spain, UK, Japan, USA and France engaged in successive devaluations. In the end, little was gained in terms of relative competitiveness

- Sometimes governments will devalue their currencies to help their exporters to compete
  - "Competitive" currency devaluation are akin to a price war, and can only be sustained if the country's finances are strong

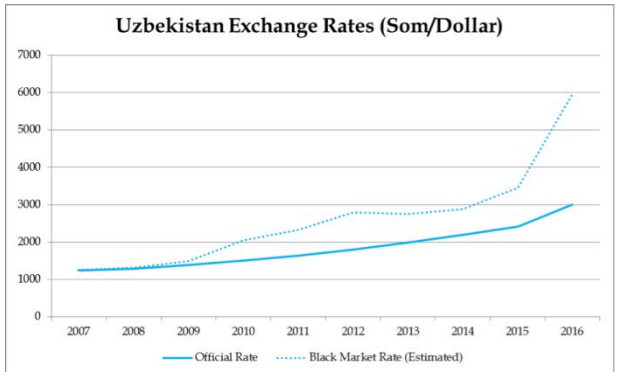
Fixed, tiered exchange rates

The most extreme form of managed exchange rate is to have different rates for imports and exports. In these cases, the central bank controls the issue of forex



❑ Advantages of tiered exchange rates:

- Government fixes a high exchange rate for imports of essential imports
  - This makes it cheaper for consumers
- Government fixes a low rate for imports of luxury items
  - This makes it more expensive for consumers
- Government fixes an even lower rate for exports
  - This helps domestic firms compete in global export markets



❑ Disadvantages of tiered exchange rates:

- Difficult to set the right exchange rate
- An invitation to corruption

Infrastructure development

Infrastructure development

An interventionist approach to infrastructure development is for the government to be the principal builder of facilities like ports, roads, schools and hospitals

- The decision on who builds the infrastructure will often depend on whether profits are available
  - The majority of projects such as schools, or rural roads will never be profitable
    - The private sector will never invest in projects such as these

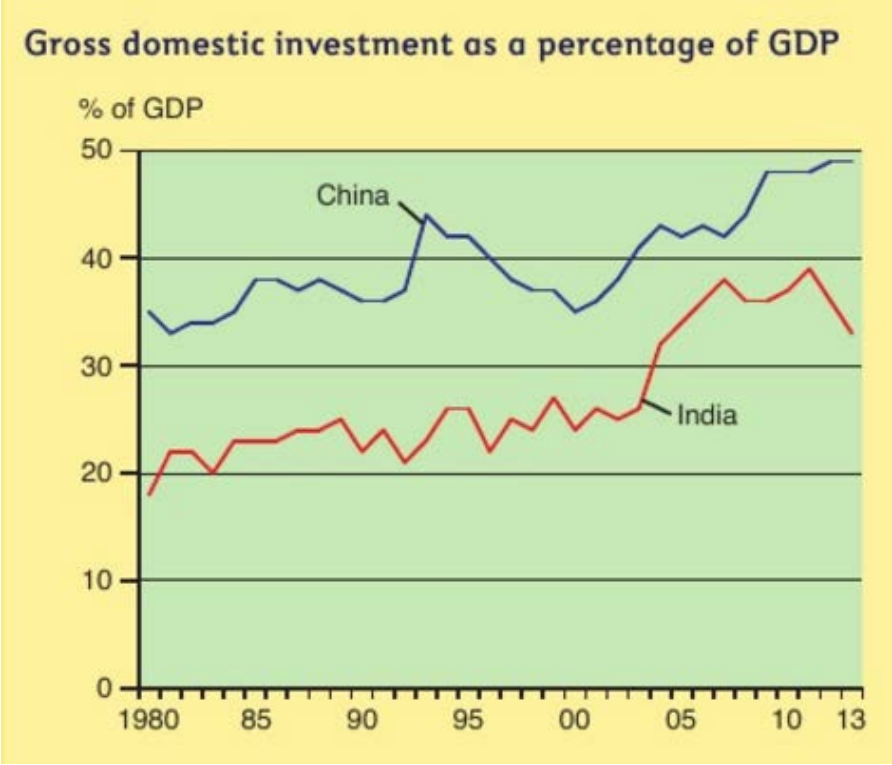
- If an infrastructure project carries with it many positive externalities, there will be a social profit
  - The government will therefore finance the construction of the project
    - The government may also undertake the actual construction of the project too

- Disadvantages of government infrastructure spending
  - With no profit motive, costs will not be kept to a minimum and building might be of poor quality

Infrastructure development

Sometimes governments will embark on large-scale infrastructure spending as a way of kick-starting AD during periods of weakness elsewhere in the economy

- China's authoritarian central and local government apparatus has enabled it to push through huge infrastructure projects despite local opposition
  - After the collapse of global trade due to the Global Financial Crisis of 2007-08, China's infrastructure investment reached nearly 50% of GDP



- Some of the projects could be considered excessive. This is the US$16bn Jiaozhou Bay Bridge – the world's longest cross-sea bridge, stretching nearly 26 miles — almost the length of a marathon

Promoting JVs with global companies

Joint ventures with Multi-National Corporations

One way that governments can reduce the risk of being exploited by Multi-National Corporations is to force them to form joint ventures with domestic companies

- The local partner will provide some finance and probably also the land for the JV in a development zone set up by the government
  - The foreign partner will provide the expertise and will import the specialist equipment from overseas
    - Over time, local employees will acquire the skills to run the plant themselves without the need for expensive expatriate staff

LNG project in Angola: owned by Chevron (36.4%), Total (13.6%), BP (13.6%), and ENI (13.6%). The Angolan state-owned oil company owns 22.8%

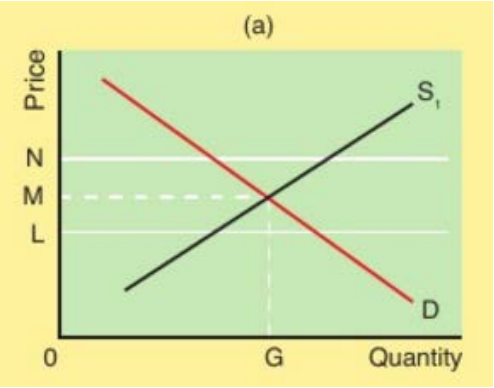
- An added benefit is that only a portion of the profits will be repatriated out of the host country
  - This will reduce the flow of currency out of the country, thus helping the current account of the balance of payments

Buffer stock schemes

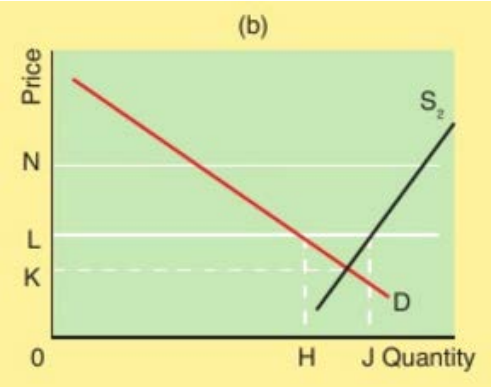
Reducing the volatility of commodity prices

Governments of commodity-producing countries can group together to establish buffer stock schemes. These are aimed at stopping commodity prices from falling

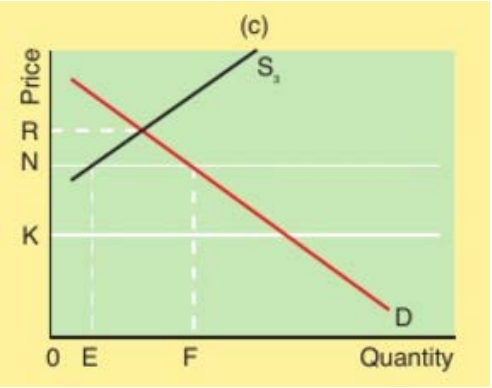
- Buffer stock schemes combine elements of both minimum and maximum prices
  - If the free market commodity price falls below a pre-set minimum price…
    - The buffer stock scheme will buy the commodity for its stockpile, thus raising prices
  - If the free market commodity price rises above a pre-set maximum price…
    - The buffer stock scheme will sell some of its stockpile of the commodity, thus causing prices to fall



a) Free market price is at M, between maximum price N and minimum price L: no intervention is necessary



b) Free market price is at K, below the minimum price L: buffer stock buys in quantity H→J to raise price to up to minimum L

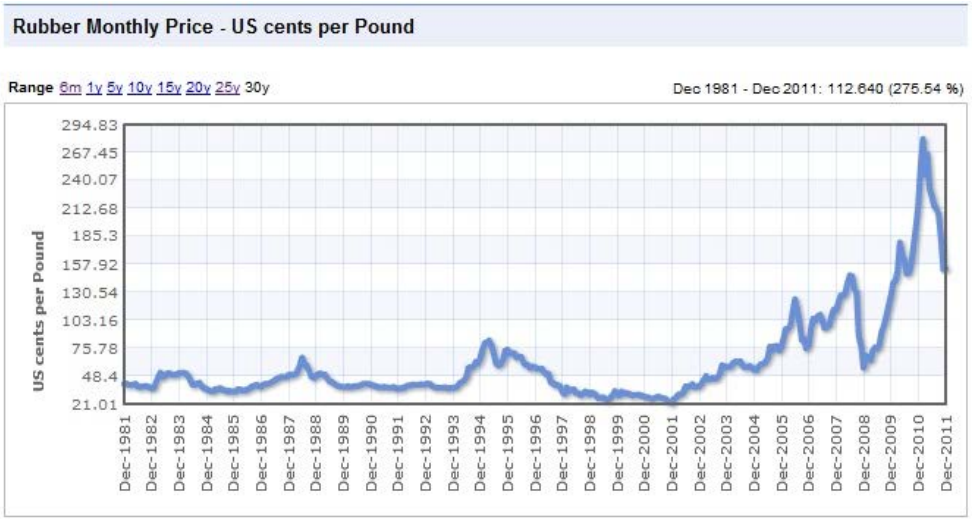


c) Free market price is at R, above the maximum price N: buffer stock sells in quantity E→F to bring down price back to maximum N

Advantages of buffer stock schemes

Buffer stock schemes are not common, because they need a lot of capital to finance purchases and to store the stockpile. But they do have significant advantages…

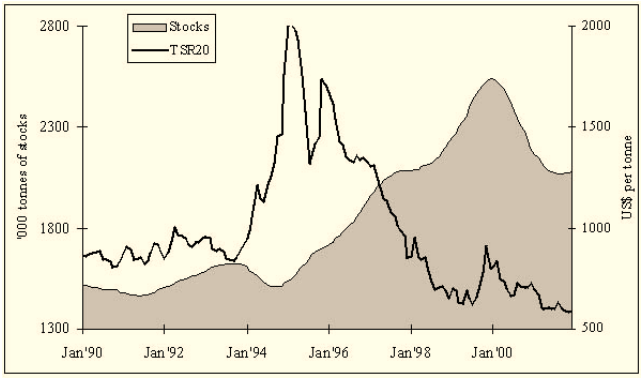
- By stabilising prices, firms in the industry are encouraged to invest
  - Farmers can also plan for the long term and are prevented from sinking into absolute poverty
    - Processing firms and other consumers of the commodity also benefit from less price volatility

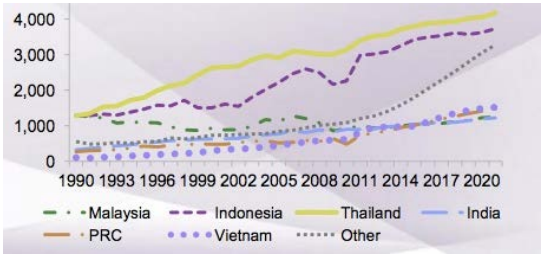


Disadvantages of buffer stock schemes

First and foremost, the commodity must be able to be stored for long periods of time without deteriorating. This rules out many types of food products

- For the scheme to work, the price of the commodity must rise and fall
  - If the price of the commodity keeps on falling….
    - The scheme will run out of money needed to buy in the commodity
  - If the price of the commodity keeps on rising….
    - The scheme will run out of physical stockpile to sell into the market





- A buffer stock scheme cannot prevent free riders from benefiting from the price intervention
  - It can never sign up 100% of producers into contributing money to the scheme

- Where to set the minimum price?
  - Usually the minimum price is set too high
    - This leads to over-production, with tax-payers effectively subsidising the commodity producers