Chapter 40

Constraints on growth and development

Key terms

1. Capital flight: when savings are sent abroad by citizens and firms of a country to another country which is either seen as being more secure or where the money can be hidden from government authorities.
2. Foreign currency(exchange gap): the different between the actual level of exports and the level of exports and the level of exports needed to create higher economic growth for an economy; sometimes called the foreign exchange gap.
3. Harrod-Domar growth model: a model which suggests that economic growth is dependent on the saving ratio and technological progress.
4. Prebisch-Singer hypothesis: suggests that over the long run, the price of commodities will fall compared to all other goods, such as manufactured goods; this suggests that countries with a high export dependency on primary products will experience a continued worsening of their terms of trade.
5. Resourse curse: exists where an abundance of natural resources in a country is exploited, but there is consequently little increase in economic development.
6. Saving gap: in development economics, the difference between the actual level of savings in an economy and the level of savings needed to finance the investment required for a higher rate of economic growth

1. Economic factors which contain growth and development

1.1 Volatility of commodity prices

↳ It highly affects GDP, if the country exports oil and price of oil fall. It leads to a fall in export revenue.

1.2 Primary product dependency

↳ When commodity prices are declining, the terms of trade for commodity export dependent countries fall. They can afford to buy fewer goods and services from abroad with revenues earned from the sale of commodities.

The Prebisch-Singer hypothesis

↳ Prebisch-Singer hypothesis: suggests that over the long run, the price of commodities will fall compared to all other goods, such as manufactured goods; this suggests that countries with a high export dependency on primary products will experience a continued worsening of their terms of trade.

1.3 The saving gap, foreign currency gap and capital flight

↳ **Harrod-Domar growth model** : this theory states that investment, saving and technological change are the key variables in determining economic growth.

↳ The policy implications of the Harrod-Domar model are clear. Increasing the rate of economic growth is a simple matter of either increasing the saving ratio in the economy (which will increase the amount of investment) or making technological progress (which will allow more output to be produced from a single unit of that capital)

1.4 Foreign currency gap

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

1.5 Capital flight

↳ Capital flight: when savings are sent abroad by citizens and firms of a country to another country which is either seen as being more secure or where the money can be hidden from government authorities.

1.4 Demographic factors

↳ high population due to uncontrollable birth rate

↳ aging population > government has to spending on health care/pension

1.5 Debt

↳ Foreign currency debt was a major problem for many developing countries in the 1980S and 1990S. The governments of developing countries were encouraged by banks to borrow US dollars at low rates of interest. However, rise in value of US dollar against other currencies will increase in interest rates.

1.6 Access to credit and banking

↳ a lack of credit and banking restrictions development.

↳ people cannot lend money to invest.

1.7 Infrastructure

↳ Many developing countries have an infrastructure gap : the amount and quality of infrastructure is too low. This reduces efficiency in the economy and slows economic growth. Eg. Problems with power suppliers or poor-quality roads will add to the costs of firms and reduce output. A lack of infrastructure also reduces labour mobility and the ability of children to travel to school and poor infrastructure will deter FDI. All these factors will limit supply-side growth in the economy.

1.8 Education and skills

Poor quality education can have many causes. Governments of developing countries will have fewer resources per capital than more developed ones to invest in education. Some countries teacher absence is high and training is low. A working population with low or out-of-date skills will reduce innovation in the economy and restrict labour mobility. All this will reduce potential growth.

2. The impact of non-economic factors

There are many non-economic factors that influence development and economic growth.

2.1 Corruption

2.2 Poor governance

Growth and development are promoted by good governance and the rule of law. Where the rule of law is weak, there is often a lack of property rights; individuals and businesses are unable to use the law to defend their ownership of assets. The result is lower investment and lower output.
Too much bureaucracy and regulation can also be a result of poor governance. It is very costly and time-consuming to set up a legal business.

2.3 Civil wars

War can destroy both physical and human capital. The LRAS will shift to the left and PPF will shift inwards. Real GDP will fall as economic activity is disrupted.

2.4 Migration

When the UK leaves the EU (Brexit), there is likely to be less flow of migrant between the UK and the EU. Some industries in the UK are concerned that the lower supply of migrants into the UK will push up wage costs and lower productivity. This will impact negatively on economic growth for the UK.

2.5 Terrorism

Terrorism is that it reduces FDI inflows for developing countries. However, individual terrorist incidents are likely to have a smaller impact than long-term terrorism problems.

2.6 Other constraints

Exercise Chapter 40

Constraint of economic growth

1. (June/2014)

(A) To what extent is rapid population growth a constraint on a country's economic development? (15 marks)

(B) 'Providing debt relief for developing countries is the best way to promote their economic growth.' Critically examine this statement in relation to a developing country or countries of your choice. (25 marks)