Edexcel Economics A-level

Unit 4: The Global Economy

Topic 6: Measures to Promote Growth and Development

6.2 Government-led strategies

Notes

The government intervenes in the market to try and influence growth and development using interventionist strategies.

- **Development of human capital**
  By developing human capital, the skills base in the economy would improve. This would improve productivity and allow more advanced technology to be used, since workers will have the necessary skills.

  Businesses struggle to expand where there are skills shortages. It also limits innovation.

  Primary school enrolment has increased from about 80% to around 90% of children. However, secondary and tertiary education enrolment is still low.

  By developing human capital, the country can move their production up the supply chain from primary products, to manufactured goods and to services, which can earn them more.

- **Protectionism**

  Protectionism can help reduce a trade deficit. This is because they will be importing less due to tariffs and quotas on imports.

  It can protect infant industries, which are relatively new and need support. Protectionism is usually short term until the industry develops, at which point the industry can trade freely.
  However, protectionism could distort the market and lead to a loss of allocative efficiency. It prevents industries from competing in a competitive market and there is a loss of consumer welfare. Consumers face higher prices and less variety. By not competing in a competitive market, firms have little or no incentive to lower their costs of production.

  Moreover, tariffs are regressive and are most damaging to those on low and fixed incomes.

  There is also the risk of retaliation from other countries, so countries might become hostile.

- **Managed exchange rates**

Managed exchange rate systems combine the characteristics of fixed and floating exchange rate systems. The currency fluctuates, but it does not float on a fully free market. This is when the exchange rate floats on the market, but the central bank of the country buys and sells currencies to try and influence their exchange rate.

- **Infrastructure development**

Examples of physical infrastructure include transport, energy, water and telecommunications.

Higher supply costs delay businesses and it reduces the mobility of labour.

For example, India's poor irrigation system makes it difficult to sustain food grain production if there is low rainfall. It hurts the poorest communities and it leads to rising food prices. There are also regular power cuts. The lack of a continuous supply of electricity affects transport, communication and healthcare. It is estimated that $400 billion needs to be invested in power to meet the development goals.

The Asian Infrastructure Investment Bank (AIIB) is led by China and it funds Asian energy, transport and infrastructure. The UK is one of the founding members, along with Germany, Australia and South Korea. The UK's involvement should give British firms an opportunity to invest in fast growing economies.

Infrastructure development is a top priority for the Chinese government. From the late 1990s to 2005, 100 million Chinese people benefited from improved power and telecommunications. Employment can be boosted with improved roads, railways and airport constructions. However, some remote areas still have non-mechanised means of transport.

Some economists argue that the development gap between China and other emerging economies is due to its focus on infrastructure projects. China invested 9% of their GDP in infrastructure in the 1990s and 2000s, whilst most emerging economies only invested around 2%-5% of GDP.

China has the first and only high speed Maglev train system in the world between the city centre in Shanghai and its international airport. Some economists might argue that is it unnecessary to build more airports, since there are already almost 200 airports in China and about 80% of people live within 100km of an airport in China. There is an opportunity cost of not investing funds elsewhere.

More information on the AIIB can be found here:

http://www.bbc.co.uk/news/business-31867934
http://www.bbc.co.uk/news/business-31921011

- **Promoting joint ventures with global companies**

  This occurs when a partnership is formed between two firms based in multiple countries.

  They allow the firm to participate in international trade, without the responsibilities involved of it. They help technological knowledge to be transferred, which can help improve and develop small companies.

  Joint ventures open up new markets for small firms, so they can distribute their products to customers. This saves them time and funds. It also spreads their risk, which is important in industries where developing a product is expensive.

  A joint venture with a global company also helps firms penetrate a foreign market, which is usually difficult because of barriers to entry.