Edexcel (B) Economics A-level

Theme 3: The Global Economy

3.6 Inequality and Redistribution

3.6.2 Reducing poverty

Notes

Economic development and economic growth

Economic growth is the increase in a country's real national output. This is caused by increases in the quality or quantity of factors of production, which cause an outward shift in the PPF.

Economic development refers to living standards, freedom (from oppression) and life expectancy. It gives an indication of how the quality of life for citizens in the country has improved. Essentially, it covers a more moral side to economic growth and it is normative. Development is also concerned with how sustainable the economy is and whether the needs of future generations can be met.

International aid and improvements in welfare; non-governmental organisations (NGOs)

Africa has been a top recipient of Chinese aid. By the end of 2009, it received 45.7% of China's cumulative foreign aid. It is important as a policy instrument for China with engagement with Africa.

Consumers in LEDCs have a higher propensity to consume than save, due to their limited incomes. Capital inflows, including those in the form of aid, can help fill this savings gap.

Aid provides temporary assistance to a country, such as humanitarian aid offered to countries after conflicts or natural disasters. Aid could also be a grant for a project that a country might not have the funds for.

Aid could be used to reduce human capital inadequacies or to pay off debt. It can improve infrastructure, which can help make the country more productive.

However, the benefits of aid are limited by corrupt leaders, the size of the aid payment and the potential for the recipient country to become dependent on aid.

Dambisa Moyo and Jeffrey Sachs are two prominent economists who have looked at the effects of foreign aid. Dambisa Moyo is generally against aid, whilst Jeffrey Sachs is generally pro-aid. It is worthwhile to have a look at some of their research and ideas. To briefly summarise, two of Moyo's arguments are that corruption means aid does not go where it is intended and that dumping goods, such as mosquito nets, into a country means private firms cannot compete and are forced out of business. Sachs suggests that it is possible for rich countries to meet the UN MDG of investing 0.7% of GDP into developing countries, which can help them improve infrastructure, yet this target is not being met.

NGOs could be funded by governments, firms or private individuals, but they are not part of governments or for-profit businesses. They are voluntary groups which aim to raise the voices of ordinary citizens. Usually, they focus on particular issues such as human rights, healthcare or the environment.

Poverty reduction policies

- **Promotion of FDI**

FDI is the flow of capital from one country to another, in order to gain a lasting interest in an enterprise in the foreign country.

FDI can help create employment, encourage the innovation of technology and help promote long term sustainable growth. It provides LEDCs with funds to invest and develop.

- **Microfinance schemes**

Microfinance involves borrowing small amounts of money from lenders to finance enterprises. It increases the incomes of those who borrow, and can reduce their dependency on primary products. There could be a multiplier effect from the investment of the loan.

They are small loans for usually unbankable people. It allows them to break away from aid and gives borrowers financial independence. In Bangladesh, 95% of microfinance cohorts are women.

Microfinance loans detach the poor from high interest, exploitative loan sharks. They could help businesses to be set up, although the money could also be spent on immediate consumption, rather than investment. Since the money goes directly to SMEs, it can stimulate employment.

However, the data collected on microfinance loans might not be reliable if there is dishonesty regarding where the money was spent.

In Tamil Nadu, India, less than 2% of microenterprises were still operating after their establishment.

Microfinance loans have high repayment rates.

- **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.

- **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