WJEC (Eduqas) Economics A-level

Trade Development

Topic 1: Global Economics

1.3 Non-UK economies

Notes

Characteristics of developed, developing and emerging (BRICS) economies

LEDCs

Less economically developed countries (LEDCs) tend to be characterised by the following features:

- Low life expectancies
- High mortality rates
- High dependency ratio
- Low GDP
- Fast population growth
- Low levels of education
- Poor standard of living
- Poor nutrition, lack of access to clean, safe drinking water and a lack of sanitation
- Poor or absent health care provision

MEDCs

More economically developed countries (MEDCs) are characterised by:

- Long life expectancies
- High income per capitas
- High levels of education
- Slow population growth per year
- Low mortality rates
- Urban and city populations are large

Impact of emerging economies

The collapse of communism has meant that more countries, especially developing countries, are participating in world trade.

International trade is arguably more important for developing countries than developed countries. It contributes towards 20% of LDC economies compared to 8% of the US economy.

Between 1995 and 2005, India's share of textiles and clothing fell from 35% in 1995 to 16% in 2005. Instead, India's manufacturing sector seems to produce more engineered goods than clothing and textiles. This has resulted in UK manufacturers selling fewer manufactured goods abroad.

China and India are important for African infrastructure. They have invested in their infrastructure in exchange for natural resources.

Both China's and India's share in agriculture, mining and fuel has declined. Both countries are important in the Euro area, with trade and financial relations. China is a main import source, whilst both are important for capital.

Impact of economic and non-economic factors in different countries

Primary product dependency

Primary products are raw materials in industries such as agriculture, mining and forestry. Mining accounts for just over 60% of South Africa's exports. Their ability to pay foreign debts and for imports relies on this.

Several developing countries rely on these primary products as a significant part of their economy. One issue with this is the v**olatility of commodity prices** that can make it hard for workers to plan for the future, and it means incomes of farmers are fickle and hard to predict.

A fall in the price leads to a fall in export incomes, which can make it hard to fund their infrastructure and education. Moreover, relying on primary products is not necessarily sustainable, since they could be over extracted and run out.

Savings gap: Harrod-Domar model

In many developing countries, there is only limited wealth, which means money cannot be put aside for the future, and they can only afford to spend in the short run. Consumers have to focus on their immediate needs, including food and safe water, to ensure they can survive. Without sufficient savings, there is inadequate capital accumulation.

Africa's saving rate is around 17%, whilst the average for middle income countries is around 31%. This makes it more expensive for the African public and private sectors to get funds since they have higher borrowing costs. This impedes capital investment.

The Harrod-Domar model states that investment, saving and technological change are required in an economy for economic growth. The rate of growth increases if the savings ratio increases. This leads to increased investment and technological progress, which leads to higher productivity.

The rate of growth is calculated by the savings ratio / capital output ratio in the Harrod-Domar model. Growth increases with more saving or a small capital output ratio.

The limitations of the model are that there is a low marginal propensity to save in some countries, or that there might be a poor financial system. Funds might not lead to borrowing and investment. There could also be inefficiency in the workforce.

Moreover, the paradox of thrift could be considered. An increase in savings could lead to an increase in investment. However, an increase in savings means there is a reduction in spending, which leads to a fall AD.

- **Foreign currency gap**

A foreign currency gap exists when the country is not attracting sufficient capital flows to make up for a deficit in the capital account on the balance of payments. In other words, the value of the current account deficit is larger than the value of capital inflows.

- **Capital flight**

This is when capital and money leave the economy through investment in foreign economies.

It is triggered by an economic threat, such as hyperinflation or rising tax rates. It can worsen an economic crisis and cause a currency to depreciate.

- **Demographic factors**

The population can impact the growth and development of a country. There is a link between keeping birth rates down and fighting hunger, poverty and environmental damage. Rapid population growth has complicated efforts to reduce poverty and eliminate hunger in Africa. The current population of 1.1 billion is expected to double by 2050, which is not sustainable.

- **Debt**

The debt crisis emerging in the developing world threatens the fight against poverty and inequality.

- **Access to credit and banking**

Without a safe, secure and stable banking system, there is unlikely to be a lot of saving in a country.

- **Infrastructure**

Poor infrastructure discourages MNCs from setting up premises in the country. This is since production costs increase where basic infrastructure, such as a continuous supply of electricity, is not available.

- **Education/skills**

This is important for developing human capital. Adequate human capital ensures the economy can be productive and produce goods and services of a high quality. It helps generate employment and raise standards of living.

- **Absence of property rights**

Weak or absent property rights mean entrepreneurs cannot protect their ideas, so do not have an incentive to innovate.

- **Corruption**

In sub-Saharan Africa, the money lost from corruption could pay for the education of 10 million children per year in developing countries.

- **Poor governance/civil war**

This could hold back infrastructure development and is a constraint on future economic development. It could destroy current infrastructure and force people into poverty.

- **Vulnerability to external shocks**

For example, an earthquake prone country is likely to find it hard to develop their infrastructure, and people might be pushed into poverty. Nepal was already one of the poorest countries in the world, but the Nepal earthquake in 2015 pushed more people into poverty.

European Union

○ The Eurozone

This is a monetary union. Members of a monetary union share the same currency. This is more economically integrated than a customs union and free trade area. The Eurozone is an example of this.

A common central monetary policy is established when a monetary union is formed. The single European currency, the Euro, was implemented in 1999 to form the Eurozone.

Monetary unions use the same interest rate. The Euro, for example, floats against the US Dollar and the Pound Sterling. Member nations are required to control their government finances, so budget deficits cannot exceed 3% of GDP. This is one of the four convergence criteria countries have to meet in order to join the Euro. The other three are:

- Gross National Debt has to be below 6% of GDP
- Inflation has to be below 1.5% of the three lowest inflation countries
- The average government bond yield has to be below 2% of the yield of the countries with the lowest interest rates. This ensures there can be exchange rate stability.

The optimal currency zone is created when countries achieve real convergence. Member countries have to respond similarly to external shocks or policy changes. There has to be flexibility in product markets and labour markets to deal with shocks. This could be through the geographical and occupational mobility of labour, and wage and price flexibility in labour markets. Fiscal transfers could be used to even out some regional economic imbalances.

European Union

Trade creation and trade diversion

With more trading blocs, trade has been created between members, but diverted from elsewhere. Trade creation occurs when a country consumes more imports from a low cost producer, and fewer from a high cost producer. Trade diversion occurs when trade shifts to a less efficient producer. Usually, a country might stop importing from a cheaper producer outside a trading bloc to a more expensive one inside the trading bloc. Moreover, protectionist barriers are often imposed on countries who are not members, so trade is diverted from producers outside the bloc to producers within the trading bloc. The UK trades mainly with the EU, at the expense of former trade links in the Commonwealth.

- **Reduced transaction costs**

Since there are no barriers to trade or no border controls, it is cheaper and simpler to trade.

- **Economies of scale**

Firms can take advantage of a larger potential market in which to trade. For example, the EU has 500 million people to sell to. By specialising, firms and countries can exploit their comparative advantages, and the gains of efficiency and advanced technology can be reaped.

- **Enhanced competition**

Since firms operate in a more competitive market, they become more efficient and there is a better allocation of resources. There could be the long run benefits of dynamic efficiency too, although these benefits are not always spread evenly across each member.

- **Migration**

By being a member of a Customs Union, the supply of labour is increased, which could help fill labour shortages. However, this might mean some countries lose their best workers.

This summary by the BBC summarises the main costs and benefits of EU membership for the UK:

http://www.bbc.co.uk/news/uk-politics-20448450