

Development

**Economic Development**

- Increases access to life sustaining goods – food, shelter, water, clothing etc
- Higher incomes mean greater access to education and jobs that increase an individual's opportunities
- Gives individuals more freedom to make economic, social and political choices
- Reduces poverty, inequality in a growing society; growth needs to be inclusive to support development

*While growth can help increase incomes, development also encapsulates cultural and human values, e.g. self-esteem not just material well-being*

Measures of development

**The UN's Human Development Index (HDI)**

- Health – life expectancy at birth
- Education – mean years of schooling and expected years of schooling
- Living standards – GNI per capita at PPP

*Each dimension is measured on a scale from 0 to 1, with 1 being the highest achievement. The HDI combines these values by taking the geometric mean of the three. Each is given the same importance*

**HDI Values**

- Very high for HDI of 0.80 and above
- High from 0.70 to 0.799
- Medium from 0.550 to 0.699
- Low below 0.550

**Is the HDI a good measure of development?**

HDI is holistic, simple, useful for policy guidance, good for global comparisons. **But** it does not cover all elements of development progress, the data may not always be accurate, giving equal weighting to each element may fail to allow for a country's development priorities, hides regional, income and educational inequalities.

**Gini Coefficient:** Measures income inequality within a country, indicating the distribution of income and wealth

**Gender Inequality Index:** Evaluates gender disparities in health, education, and economic participation

**Multidimensional Poverty Index (MPI):** Considers factors such as health, education, and living standards to assess poverty and deprivation in multiple dimensions e.g. child mortality, access to water & cooking fuel, sanitation....

**Environmental Sustainability Indicators:** Evaluates a country's impact on the environment e.g. carbon emissions, natural resource depletion, and pollution.

**Human Poverty Index (HPI):** Focuses on severe deprivation in health, education, and standard of living, emphasizing the most disadvantaged populations.

**Social Progress Index (SPI):** Measures various aspects of well-being, including basic human needs, foundations of well-being, and opportunity.

**Sustainable development goals (SDGs)**

- |   |   |
|---|---|
| 1. No Poverty                             | 10. Reduced Inequality                    |
| 2. Zero Hunger                            | 11. Sustainable Cities & Communities      |
| 3. Good Health & Well-being               | 12. Responsible Consumption & Production  |
| 4. Quality Education                      | 13. Climate Action                        |
| 5. Gender Equality                        | 14. Life Below Water                      |
| 6. Clean Water & Sanitation               | 15. Life on Land                          |
| 7. Affordable & Clean Energy              | 16. Peace, Justice, & Strong Institutions |
| 8. Decent Work & Economic Growth          | 17. Partnerships for the Goals            |
| 9. Industry, Innovation, & Infrastructure |   |

*The SDGs are designed to be universally applicable and are meant to be achieved by 2030. They serve as a framework for governments, organisations, businesses, and individuals to work collectively toward a more sustainable, equitable, and prosperous future for people and the planet.*

### Primary product dependency

**Primary product dependency:** when a country has a high dependence on extracting & then exporting primary commodities, making it vulnerable to volatile global prices and terms of trade

**Export-commodity-dependent country:** when more than 60 per cent of its total merchandise exports are composed of primary commodities.

**Prebisch-Singer Hypothesis (PSH):** over the long run, real prices of primary commodities such as coffee decline relative to prices of manufactured goods such as cars because primary products have a lower income elasticity of demand (and we expect global income to rise)

### Resource curse/Dutch disease/petrocurrency effect

**Resource curse:** a natural resource find attracts inward investment causing the currency to appreciate and making other industries such as manufacturing less internationally price competitive

**Dutch Disease:** term used for the resource curse after this happened in the Netherlands when natural gas was found

**Petrocurrency effect:** when the resource found is oil and the currency then appreciates due to increasing exports of oil

### Problems caused by primary product dependency

- Risk of corruption, political conflict, land grabs by MNCs
- Resource extraction is capital- intensive – redistributes income to capital owners/politicians
- Vulnerable to global commodity price volatility – can cause unemployment in countries with little welfare support
- Over-rapid extraction damages the environment; growth may be unsustainable
- Currency may appreciate (resource curse) making exports less price competitive, which may cause de-industrialisation and exacerbate primary product dependency

### Policies to reduce primary product dependency

- **Economic diversification:** develop/support non-primary sectors such as manufacturing, services, and technology.
- **Agricultural and rural development:** promote modern farming techniques and sustainable agriculture to increase output and reduce dependency on a limited range of primary products.
- **Export diversification:** to reduce dependence on a single buyer or a few countries. Seek new trade partners and explore emerging markets.
- **Human capital development:** invest in education and vocational training to develop a skilled and adaptable workforce. Foster a culture of innovation and entrepreneurship to drive diversification.
- **Value added:** add value to primary products through processing, manufacturing, and refining
- **Better governance:** makes it clearer where tax revenues from natural resource find are being spent
- **Stabilisation fund/Sovereign Wealth Fund (SWF):** to ensure extra income is used to fund education/healthcare/infrastructure.

### Volatile commodity prices

Volatile commodity prices can cause uncertainty; it is unpredictable for a commodity producer what will happen to export earnings and the terms of trade over time; uncertainty also deters investment.

#### **When prices fall unexpectedly:**

Fall in export earnings  
Trade deficit  
Fall in revenue/profits for producers  
Loss of government revenue  
Unemployment  
Depreciation of currency

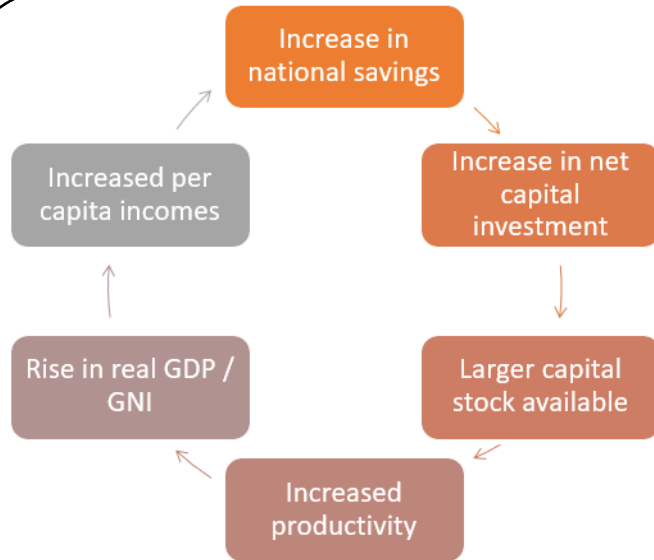
#### **When prices rise unexpectedly:**

Rise in export earnings  
Economic growth  
Inflation pressure  
Trade surplus  
Appreciation of currency  
Income inequality  
Increase in government revenue

**Savings-Investment Gap**

**Savings gap:** in low-income countries, extreme poverty and weak financial markets makes it hard to generate enough savings to fund capital investment projects that could boost development

**Harrod-Domar Model**



This model stresses the importance of savings and investment. The rate of economic growth depends on:

- Level of national saving (S)
- Productivity of investment (capital-output ratio)

**Rate of growth of GDP = savings ratio / capital output ratio**

The Harrod-Domar model suggests that a higher savings ratio leads to an increased rate of investment (in a closed economy), thereby helping to building the capital stock of a country as a result, and increasing output through a rise in productive capacity (LRAS).

**Overcoming a savings gap**

- Attract inflows of FDI
- Inflows of external/overseas aid
- Net inflows of remittances from workers based abroad
- Behavioural interventions to encourage people to save
- Industrialisation to increase wages
- Cash transfer/minimum wage policies

**Foreign currency gap**

**Foreign currency gap:** when outflows of currency exceed inflows of currency, caused by:

- Current account deficit
- Capital flight
- Fall in remittances from overseas workers

**Problems caused:** a country does not have enough foreign currency to pay for imports such as medicines/food/raw materials/capital goods/components hampering short run economic growth and development outcomes

**Reducing a foreign currency gap:** the government needs to attract external sources of finance (FDI, portfolio investment, loans – short and long-term, foreign aid and remittances)

**Capital flight**

**Capital flight:** the rapid outflow of capital (money, assets, investments) from a country often due to economic/political/social instability.

**Problems caused:**

- Reduction in funds for domestic investment in education / healthcare / infrastructure
- Depreciation of currency increases the cost of imports, leading to inflation
- Loss of tax revenue which could have been used to finance public services and development initiatives
- Higher borrowing costs for the government increasing debt service costs, straining national budgets, & diverting resources from development priorities

**Reducing capital flight:** implement stable economic policies, improve governance and transparency, and provide incentives for domestic investment

**Demographic problems**

**Rapid population growth:** can strain resources, infrastructure, and social services, leading to issues such as overcrowding, unemployment, lack of food and housing.

**Youth bulge:** challenges providing education, employment opportunities, and social services, leading to social unrest and instability.

**Ageing population:** due to declining fertility rates/improved healthcare can strain pensions, healthcare services, and cause labour shortages

**Net migration:** movement of workers into/out of a country can cause problems eg labour shortages/excess, strain on public services

**Rapid urbanisation:** can lead to unplanned expansion of cities, inadequate infrastructure, slum proliferation environmental degradation & inequality

**Healthcare needs:** may not be met leading to high maternal and infant mortality rates, infectious disease spread, and limited access to essential healthcare facilities

**Educational challenges:** hard to provide for all, leading to high illiteracy rates, skills gaps, and limited opportunities for socio-economic advancement.

**Gender inequality:** in education, employment, and access to resources can hinder women's empowerment and contribute to inequalities

**Advantages and disadvantages of rapid population growth**

- Expansion of working age population (increase in LRAS)
- Increase domestic market size
- Wider tax base
- Rural-urban shift can generate agglomeration economies of scale
- Catalyst for innovation to boost e.g. crop yields
- Youth unemployment
- Hard to ensure all people's basic needs are met
- Pressure on the natural environment
- Higher urban density can increase crime/disease/social problems
- Increased inequality

**Net migration**

**Net emigration:** a net outflow of workers from a country

**Advantages:** skills and knowledge transfers back to home country, remittance inflows, alleviation of population pressures

**Disadvantages:** brain drain/skill loss, may leave behind an ageing population, loss of human capital investment

**Net immigration:** a net inflow of workers from outside a country

**Advantages:** workforce growth, more economic growth, skills gaps filled, more entrepreneurship & innovation; cultural diversity

**Disadvantages:** strain on resources/public services/housing, social tensions, integration issues, remittance outflows

**Ageing population**

- More saving
- Experience / knowledge / expertise
- Stimulate growth & innovation of healthcare sector
- Social stability
- High dependency ratio
- Labour shortages
- Pressures on health & social care
- Less entrepreneurship / innovation
- More social isolation / loneliness

**External debt**

**External debt or foreign debt:** the money that a country owes to foreign creditors.

- Debt is incurred when a country borrows funds from sources outside its own borders, typically from foreign governments, international financial institutions and banks.
- External debt can be in various forms, including loans, bonds, or credit extended by international organisations

*(NB: Don't confuse with other sorts of debt such as household debt, corporate debt and the government's debt)*

**External debt****Problems caused by external debt:**

**Debt servicing costs increase:** diverting budget funds away from public services such as education, healthcare, and infrastructure.

**Macroeconomic instability:** when a country faces difficulty in servicing its debt, it may resort to inflationary monetary policies, currency devaluation, or fiscal austerity measures, all of which can hinder economic growth and reduce living standards.

**Credit rating downgrade:** makes it more expensive for the government to borrow, further constraining investment and economic activity.

**Social consequences:** including increased poverty and inequality, as reduced public spending affects essential services like education and healthcare

**Reducing external debt:** may require some debt forgiveness or debt rescheduling

**Access to credit and financing**

**Financial access** connects people into the formal financial system, such as using a bank account, access to loans, access to basic insurance

**Problems with lack of access to credit & banking:**

- people use the informal financial system, loan sharks etc, with high rates of interest
- people cannot build up savings or assets
- no insurance against poor health / illness / injury or natural disasters, such as flooding/earthquakes/cyclones
- Prevents productive investments, increased entrepreneurship & innovations
- Harder for a government to measure economic activity and collect in tax revenue to pay for public services.

**Improving access to finance and credit:** use of regulatory reforms, fostering a conducive business environment, and promoting financial inclusion initiatives such as microfinance programs

**Infrastructure gaps**

**Infrastructure gap:** when the available infrastructure resources / investments do not fully meet those infrastructural needs adequately

**Infrastructure:** includes public goods like water supply & sanitation, semi-public goods such as transport, communication & energy networks, hospital & schools

*Infrastructure projects are important and add to both AD and LRAS in an economy, often with high multiplier effects*

**Problems with infrastructure gaps:**

- Higher costs for businesses – this causes higher prices – therefore hitting real incomes for consumers
- Lower geographical mobility of labour causing higher structural unemployment
- Less attractive to FDI (slower economic growth in the long run)
- Economy more vulnerable to effects of climate change especially risks from natural disasters
- Impact on human development – including having access to safe and reliable water and sanitation services
- Can damage export competitiveness
- Can contribute to ender inequalities

**Reducing an infrastructure gap:**

- Policies to attract more FDI
- Use of aid or loans, e.g. from World Bank to invest more infrastructure
- Regulatory reforms to make business environment more conducive to private sector investment in infrastructure
- Joint ventures to increase use of technologies to improve infrastructure

**Human capital gap**

**Human capital:** the knowledge, skills, experiences, and abilities possessed by individuals in a population that can produce economic value.

**Human capital gap:** the difference between the skills, knowledge, health, and other attributes of a workforce and the level required to support sustainable economic growth and development

**Problems with human capital gaps:**

- Hinders labour productivity growth
- Reduces innovation and technological progress
- Holds back increases in entrepreneurship
- Can deter foreign investment
- Reduces economic resilience to shocks

**Closing human capital gaps:**

By prioritising spending on education (more years of schooling, more primary, secondary & tertiary provision, more schools/universities, more educational equipment and resources), healthcare (reduces malnutrition & poor health that may affect productivity), skills training, and social inclusion, developing countries can unlock the full potential of their populations and achieve sustainable economic growth and development

**Absence of property rights**

**Property rights:** need to be clearly defined for development e.g. identifying and titling land rights, protection of intellectual property, preventing illegal poaching, having the right to start & own a business, enables use of digital identity programmes; helps prevent the Tragedy of the Commons

**Failing to establish property rights** deters entrepreneurship, R&D and innovation, reduces investment that may boost agricultural productivity, limits wage growth that could lead to greater tax revenue for development projects, allows deforestation and other depletion and degradation of natural resources

**Weak institutions & corruption**

**Weak institutions:** when the legal, financial and political institutions are not well-established

**Problems with weak institutions:**

Making it more difficult to establish property rights

Makes it harder to access to credit & finance – may have to use informal financial sector (higher interest rates, loan sharks etc)

Less say in how the economy is run - may not have a democratic vote

**Corruption:** the abuse of public office for private gain – it can include, bribery of public officials when contracts are negotiated, bribery at customs facilities, money laundering, misappropriation of aid flows; illegal tax evasion

**Problems with corruption:**

- Deters foreign investment by increasing the cost of doing business – investment into a country carries a higher risk.
- More allocative inefficiency - public resources are diverted for private gain; political lobbying can sway government decisions
- More persistent income & wealth inequality and reduced progress cutting extreme poverty
- A loss of trust - a breakdown of social capital
- Poorer human development outcomes because governments are not collecting sufficient tax revenues

**Other development barriers**

- Country is land-locked with bad neighbours
- Conflict/civil war
- Poor governance/political unrest
- The geography of the country
- Too reliant on natural resources

### Market-orientated strategies

- Trade liberalisation
- Promotion of FDI
- Removal of government subsidies
- Floating exchange rate systems
- Microfinance schemes
- Privatisation

### Trade liberalisation

**Trade liberalisation:** measures to lower and remove trade barriers such as tariffs, quotas and NTBs.

#### Benefits include:

- Lower prices and more choice for consumers (increase consumer surplus)
- Larger markets, diversifies risk and economies of scale (lower LRAC) for firms
- Higher economic growth and living standards
- Exploitation of comparative advantage (greater output from same set of resources, via specialisation) increase competition & usually increases investment and productivity / dynamic efficiency
- Net welfare gain from removal of tariffs (static analysis)
- Higher profits in export industries may attract FDI and encourage domestic investment

**REVIEW: topics of free trade, protectionism, tariff model etc**

### Disadvantages of trade liberalisation

- Infant industries may be unable to compete and go out of business
- Primary product dependency
- Lack of diversity e.g. inadequate manufacturing sector
- Trade deficit may result
- Danger of dumping from foreign firms

### Disadvantages of trade liberalisation (cont'd)

- Increased unemployment (structural)
- Greater exposure to external shocks as countries are more interdependent / globalised / reliant on integrated global supply chains
- Unbalanced development – only industries where comparative advantage lies will develop; others may be left behind
- Global monopolies (TNCs/MNCs) may become larger and more powerful; use of their monopsony power to keep prices for commodities from developing countries low
- Greater international trade may be bad for the environment and climate change

### Promotion of FDI

**What is FDI?** Capital provided to or received from an enterprise by an investor in another country. It can be:-

- **resource-seeking** (e.g. Chinese investment in Africa)
- **efficiency-seeking** (e.g. European firms investing in Bangladesh to gain lower unit labour costs)
- **market-seeking** (e.g. US firm investing in EU to expand its markets).

**Impact of increased investment** is beneficial whether it comes from within an economy or if it is attracted in from outside in the form of FDI. FDI is an injection into the circular flow of income.

A change in injections leads to a multiplied change in national income (**the multiplier effect**). Multiplier's value =  $1/(1 - MPC)$

#### FDI:

- Increases short run growth (driven by AD)
- Increases long run growth (increase in LRAS)
- Inflation – if both AD and AS potential for non-inflationary growth
- Unemployment – cyclical should fall
- balance of payments inflow on financial account; FDI can improve price and non-price competitiveness, so current account balance may improve

### Policies to promote FDI

- Reduce corporation tax and other business taxes
- Increase tax incentives and grants towards investment
- Increase the ease of doing business in a country. (World Bank Report)
- Liberalisation of labour laws e.g. ease of hiring and firing workers, zero hours contracts...
- Reducing trade barriers so it is easier to import components and to export finished goods

**REVIEW: how to show the impact of FDI on an AD/AS diagram**

### Removal of government subsidies

A **subsidy** is any form of **government support**—financial or otherwise—offered to producers and (occasionally) consumers. Subsidies to **producers reduce the marginal cost of supply**. A subsidy usually leads to an **increase in the output sold** of a good or service at a **lower market price**.

**REVIEW THEME 1 topic of subsidies**

*Many developing countries had food and energy subsidies, which are very costly, can distort economic output and may misallocate resources*

### Advantages of subsidy removal

- Subsidies distort market mechanism
- Subsidies are very costly (opportunity cost), paid for by taxpayers/increased budget deficit
- Subsidies may discourage increases in productive and X-efficiency
- Firms may become over-reliant on subsidies/state aid
- Subsidies may stifle innovation as firms can make profit without innovating
- Subsidies do not always help workers; sometimes they add to profit and shareholder income increasing income inequality; corruption issue if subsidies syphoned off etc
- Subsidies may reward farmers who use more intensive farming methods which are bad for the environment – deforestation, loss of bio-diversity, water scarcity

### Disadvantages of removal of government subsidies

- Subsidies help poorer families e.g. food and energy subsidies
- Subsidies can support infant industries grow to become competitive via EoS
- Subsidies protect jobs in some industries
- Subsidies support farm incomes, promoting more capital investment, more innovation, more productivity
- Subsidies can make some health care more affordable
- Subsidies can reduce the cost of training and employing workers
- Subsidies can reduce income inequality
- Subsidies can reduce the cost of transport
- Subsidies can help correct market failure

### Floating exchange rate systems

Reasons some developing countries may fixed their exchange rate:

- to bring stability and certainty; encourages investment and FDI
- to keep currency's value low to make exports cheaper and promote export-led growth (undervaluation)
- To keep currency's value artificially high to improve the terms of trade & to bring down inflation (overvaluation)

### Impacts of allowing currency to float:

- Frees up monetary policy tools to improve domestic economy rather than keep currency at its fixed rate
- If fixed low – currency may appreciate, improves terms of trade, increase in standard of living; loss of price competitiveness; could appreciate sharply if resource curse strikes
- If fixed high – currency may depreciate, increasing international price competitiveness, exports cheaper and imports more expensive (outcome depends on PEDs, if Marshall-Lerner condition is met, may be a time lag = J-curve effect); may be inflationary

**REVIEW: exchange rate systems, pros & cons of exchange rate movements**

**Microfinance schemes**

**Microfinance schemes:** provide extremely poor people with small loans (microcredit) to help them engage in productive activities or to grow their tiny businesses. They can help the poor increase their income, build businesses and reduces vulnerability to external shocks.

- Microcredit – small loans to poor households
- Micro-savings – eg voluntary local savings organisations provided by charities
- Micro-insurance – especially for people not usually served by commercial insurance businesses
- Remittance management eg transfer payments made by mobile phone solutions

**Advantages of microfinance schemes**

- Helps break the debt-poverty cycle by shifting borrowing away from informal money lenders/load sharks
- Microcredit can help smooth consumption when incomes are volatile
- Encourages enterprise; a line of credit for small businesses
- Address gender imbalances reducing extreme poverty
- Platform for saving and investment (Harrod-Domar model of development)
- Encourages social enterprise, local infrastructure projects leading to better sanitation/water supply improving health

**Disadvantages of microfinance schemes**

- Microfinance interest rates can be very high; often market-determined
- Encourages increase in debt/sub-prime lending
- Poverty may be tackled better with improved welfare system
- May not improve investment in small businesses so productivity may not improve, income per capita may not rise
- Aid/cash transfers may be more effective for development goals

**Privatisation**

**Privatisation:** sale of publicly owned assets to the private sector through the issue of shares.

**Advantages of privatisation**

- Raises revenue for the government (& reduces budget deficit) can be used to promote development policies (education / health / infrastructure etc)
- Exposes industries to competitive market forces raising allocative / productive / dynamic efficiency
- Helps create businesses strong enough to compete globally
- Can reduce price for consumers
- Can increase flexibility of labour markets
- Imposes the discipline of the stock market and can disperse share ownership
- Frees investment decisions from state control

**Disadvantages of privatisation**

- May transfer a natural monopoly from public to private ownership; profit maximising private monopoly may restrict output and raise prices to increase profits
- Private firms may not take negative production externalities into account
- Shares are often underpriced to ensure successful sale – less revenue for the government
- Once industry is sold, it cannot be sold again – short term revenue boost only
- Private sector motivated by profit; may result in less investment and higher dividends for shareholders, higher CEO pay etc.

The success of privatisation may depend on whether there is a strong regulatory framework for private monopolies to prevent regulatory capture and exploitation of consumers

**REVIEW: THEME 3 privatisation topic**

### Interventionist strategies

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

### Development of human capital

**Human capital:** Human capital refers to the collective skills, knowledge, abilities, and experiences possessed by individuals within a population or workforce. Countries with poor education and low school enrolment ratios are likely to experience slow rates of economic growth.

Improvements in access to education and in the quality of education could help increase the skills and productivity of the workforce. Training is also important. Policies include:

- Investment in education
- Skills development programmes
- Healthcare initiatives
- Adult education courses
- Entrepreneurial support
- Gender equality policies
- Infrastructural improvements – more schools, easy access to education

**REVIEW: supply-side policies**

### Advantages of human capital development

- Boosts productivity via greater skills/occupational mobility
- Helps reduce youth unemployment
- Increases entrepreneurship
- Increases R&D and innovation
- Greater economic efficiency
- Encourages FDI by global companies

**However,** policies to promote human capital development can have a high opportunity costs, there are time lags and potential for government failure

### Protectionism

**Protectionism:** controls on imported goods, eg tariffs and quotas to promote **import substitution** (replacement of imports with domestically produced manufactured goods) – an ‘inward-looking strategy’.

- **Infant industry** strategy – often subsidised – WTO allows for developing nations to help diversify/industrialise
- **Anti-dumping** protection – WTO allows

### Advantages of protectionism

- Creates a path towards **diversification and industrialisation**
- Aims to diversify in a controlled way until it has a strong domestic base.
- Most effective where a country’s domestic market is large enough to enable industries to gain economies of scale
- Once achieved, it is strong enough to cope with foreign competition.
- Can be a source of tax revenue in countries where incomes and spending are low
- Retaliatory response to other countries using tariffs etc.

### Disadvantages of protectionism

- Comparative Advantage is distorted and resources will not be allocated efficiently
- Less specialisation and lower output; lower standard of living
- Fewer gains from trade
- Loss of potential economies of scale (EoS)
- Net welfare loss from tariffs/quotas/NTBs
- Lack of competition could result in inefficiency and higher prices for consumers
- Using export subsidies can be costly
- May raise some tax revenue but not a good long-term or reliable source of tax revenue for many countries
- Others may retaliate

**REVIEW: Tariff model and free trade & protectionism topic**

**Managed exchange rates**

**Fixed/pegged exchange rate:** government sets a central rate for its currency and intervenes by buying/selling on foreign exchange markets and/or adjusts interest rates to keep the currency at its fixed level.

**Key Advantages**

- Brings stability, better economic environment for investment and trade
- Encourages business to increase their efficiency (as can't rely on depreciation to restore competitiveness)

**Key disadvantages:**

- Interest rates have to be used to hold currency's value; loss of monetary tool to influence macroeconomy
- Can have sudden destabilising devaluation/revaluation if fixed at 'wrong' rate
- Requires foreign exchange reserves

**REVIEW: Fixed v floating exchange rate systems****High fix: overvaluation of exchange rate**

**Overvaluation:** exchange rate is fixed at a high level with the aim of keeping down the cost of imports, especially oil, raw materials and capital equipment, helping it grow and develop

**Advantages of overvaluation:**

- Cheaper imports, including imported capital goods
- Cheaper imports of food, medicine, energy etc..(helps maintain domestic political stability too)
- Acts as a dampener on inflation
- Encourages increased efficiency to retain competitiveness in domestic industry

**Disadvantages of overvaluation**

- Damage export competitiveness
- Cheap imports squeeze out domestic firms and jobs for local industries trying to compete
- Less FDI
- May require higher interest rates to support currency, slowing growth

**Low fix: undervaluation of exchange rate**

**Undervaluation:** exchange rate is fixed at a low level with the aim of increasing export competitiveness to promote export-led growth and development

**Advantages of undervaluation:**

- Boost to exporters/more price competitive
- Makes FDI more attractive to foreigners
- Greater investment and more jobs in export sector
- Protects domestic firms from import competition
- Allows more import substitution

**Disadvantages of undervaluation:**

- Less competition, more inefficiency in domestic firms
- Excess demand for labour could push up wages (if limited labour supply)
- Repatriated profits worth less on currency conversion

**Infrastructure development**

**Infrastructure:** the physical and organisational structure and facilities. Includes buildings, transport networks (roads, railways, ports, airport hubs...), energy networks (power supplies) and communication networks (internet)

**Advantages:**

- Can 'crowd in' private sector investment
- Improves labour mobility boosting productivity
- Contributes to urbanisation boosting productivity
- Increases efficiency of supply chains
- Helps get goods to markets at home and abroad, cutting transport costs
- Improves communication between businesses and their customers
- Improves information

**Disadvantages**

- High opportunity cost/cost to government
- Vanity 'white elephant' projects can mean investment is wasted
- Potential for government failure/corruption
- Crowding out
- May be more debt if funded by loans, aid with interest....

**REVIEW: Supply-side policies**

### Promoting joint ventures (JVs) with foreign companies

**Joint venture:** an association of two or more businesses for the purpose of engaging in a specific enterprise for profit. Firms may enter JVs to combine strengths and increase their competitive advantage while reducing risk

#### Advantages:

- Access to technology and expertise.
- Sharing of risks and costs.
- Access to international markets and distribution networks.
- Opportunities for knowledge transfer and skill development.
- Enhanced credibility and reputation through association with global brands.

#### Disadvantages:

- Loss of control and autonomy.
- Potential for conflicts in decision-making and management styles.
- Unequal distribution of benefits and profits.
- Risk of technology dependence and limited learning opportunities.
- Exposure to global economic fluctuations and market uncertainties.

### Policies to promote JVs

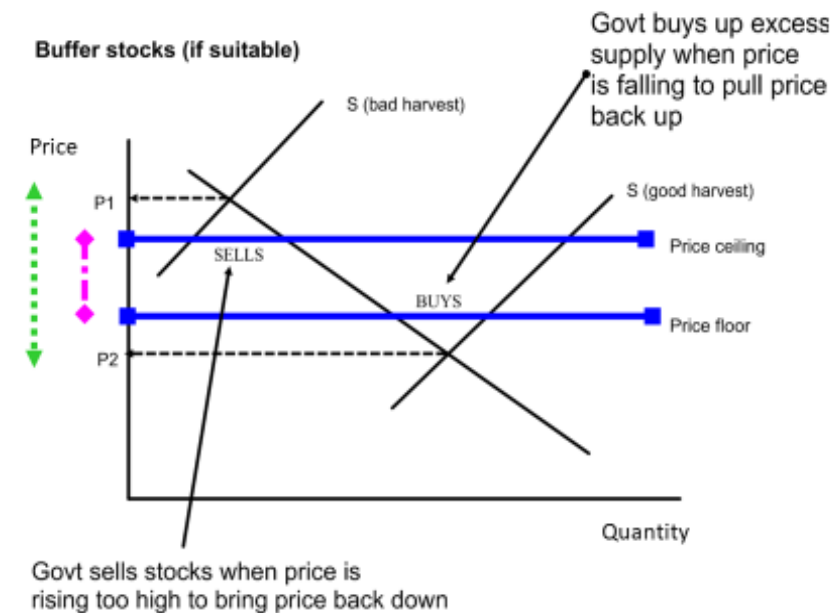
- Offering incentives such as tax breaks, subsidies, or favorable regulatory conditions.
- Facilitating access to financing and investment through government-backed loans or guarantees
- Providing infrastructure support, such as improved transportation and utilities
- Streamlining bureaucratic processes and reducing red tape to make it easier for businesses to establish JVs
- Offering assistance with market research, partner matchmaking, and legal support to facilitate JV negotiations and agreements

### Buffer stock schemes

**Buffer stock scheme:** a maximum-minimum price 'hybrid' policy designed to reduce the volatility of market prices where prices are unstable.

- If the price falls too low, the authorities buy up the excess supply until the price is back in the desired range above the price floor.
- If the price is too high, the authorities sell their stocks until the price is back in the desired range below the price ceiling.

#### How a BBS works



#### Problems with buffer stock schemes

- Initial set up costs are high
- Storage costs are often very high;
- Not suitable for perishable goods
- Need good harvest to start with, to build up stocks!!!
- Several years of bad harvests in a row means stocks will run out
- Several years of good harvests in a row mean stocks will grow
- Admin costs can be very high
- Setting intervention prices at a suitable level difficult
- Need all producers to be part of the scheme

**Other strategies**

- Industrialisation – the Lewis model
- Development of tourism
- Development of primary industries
- Fairtrade schemes
- Aid
- Debt relief

**Industrialisation – the Lewis model**

**Lewis model:** growth & development can be achieved by the migration of workers from the rural primary sector (subsistence agriculture, low productivity, barter) to the modern industrial sector, often urban, (high productivity, money used as medium of exchange) through higher wage incentives.

- Underemployed workers in agriculture become more productive in manufacturing sector, which can attract more FDI

**However**, many developing nations also have high levels of urban unemployment and manufacturing is increasingly capital-intensive

**Development of tourism**

Many developing nations can attract tourism from developed countries, bringing in income with local multiplier effects.

**Advantages:**

- Tourism demand is income-elastic (compared to primary products – see Prebisch-Singer Hypothesis)
- Tourism earns foreign currency and it labour-intensive (services such as hotels, bars...) - good for employment
- Attracts investment from TNC hotel chains, boosts GDP via multiplier, creating jobs
- More tax revenue for government helps improve public services; also revenue from tourism taxes
- Preserves national heritage of the country
- Improvements in infrastructure – eg building roads, more reliable energy to tourist spots.

**Disadvantages of development of tourism**

- May require more imports to get capital equipment needed to build hotels and facilities
- More imports to provide specialist food and goods for tourists
- Profits more be re-patriated (affecting current account on BoP)
- In global recessions, fall in demand great (as income-elastic)
- Employment may be seasonal only & jobs may be mostly low-skilled/low-paid
- Tourism is affected by changes in fashionability of destinations
- Negative externalities eg clean water for tourists but not locals, expansion of airports pollutes, increase in waste, pollution on beaches

**Development of primary industries**

Resource-rich countries can develop on the basis of their primary products; some primary products can have a high YED

- Rather than trying to develop the industrial sector, developing countries can focus on exploiting their comparative advantage in soft and hard commodities
- Earnings may be used to promote education and gradually gain comparative advantages elsewhere
- Countries can try to develop processing of their primary products before export to start some industrialisation

**However...** danger of primary product dependency, resource curse and impact on export earnings of volatile primary product prices.

**Fairtrade schemes**

**Fairtrade schemes:** correct for **market failures** in primary industries such as:

- Countering the effects of monopsony power among TNC food processors and manufacturers
- Prevent unsustainably low prices for farmers
- Address poverty and inequality for farmers in poor countries

## Advantages &amp; disadvantages of Fairtrade schemes

## Advantages

- Guarantees a higher price to certified producers
- Achieve greater price stability for growers – more income stability
- Extra earnings can be spent on improving quality of product or diversification, and/or on education, health, infrastructure, clean water, conversion to organic farming etc; improves businesses and communities
- Improve quality in production & more environmental sustainability
- Improved working conditions.

## Disadvantages

- Non-participating farmers more likely to suffer from extreme poverty
- Some of high price goes to processors not the farmers
- Fairtrade does not address key causes of poverty
- May be better to encourage development of farming co-operatives
- May cause increase in supply leading to surpluses
- Fairtrade label often co-opted by middle / higher income countries

## Aid

**Tied aid** – aid with conditions attached

**Bilateral aid** – from one country to another

**Multilateral aid** – countries pay money to an international agency such as the World Bank which distributes it to countries that meet certain criteria

**Humanitarian** – food and shelter in times of emergency

**Grants** – money that does not need to be repaid

**Soft loans** – money lent at concessionary rates of interest

*Aid can help but is also sometimes diverted to govt ministers (corruption) or channelled into high profile projects that earn global media interest, but are not much help for development in the long run.*

## Advantages &amp; disadvantages of aid

## Advantages

- Reduction in absolute poverty
- Fills the saving gap (Harrod-Domar model)
- Fills foreign exchange gap allowing more imports of capital
- Provides funds for infrastructure (AD, I, multiplier, growth)
- Improves human capital (eg train teachers and doctors)
- Helps increase globalisation and trade which tend to lead to more growth and development
- Reduces inequality between countries

## Disadvantages

- Dependency culture
- May not get to intended beneficiaries (corruption)
- No clear evidence it reduces absolute poverty, or helps increase growth and development
- Distorts market forces causing an inefficient allocation of resources (right-wing, free-market view)
- Economic imperialism – donors aim to gain influence in recipient countries
- Some aid requires interest to be paid – opportunity cost as less to spend on other public services

## Debt relief

When a country's burden of debt becomes too high, debt servicing costs can become crippling - **debt relief** or cancellation can help

Debt is usually owed to the IMF, the World Bank, or governments & banks in developed countries. Pressure to cancel the debt of the poorest countries has increased via...

- Heavily Indebted Poor Countries (HIPC) initiative (since 1996)
- Multilateral Debt Relief Initiative (MDRI) (since 2005); aims to speed up progress towards SDGs
- World Bank debt relief provision

## Advantages &amp; disadvantages of debt relief

## Advantages

- LDCs have more foreign currency to buy capital and consumer goods from developed countries
- More capital can be purchased (investment, growth, multiplier)
- Reduces absolute poverty
- Can help reduce savings gap and foreign exchange gap
- Might help environment (debt for nature swaps)

## Disadvantages

- Compared to aid, negotiating a debt relief/cancellation is time-consuming
- If no conditions (such as sound macroeconomic policy) attached to debt cancellation, moral hazard issue
- Corruption may mean debt relief/cancellation gains are channelled to govt officials not poor
- Shareholders in developed world may share burden of debt cancellation
- May be less effective than policies that reduce protectionism in developed countries

## World Bank

- Grants reconstruction loans to devastated countries
- Grants development loans to underdeveloped countries
- Helps set up agricultural reforms in developing countries giving loans and providing expertise.
- Provides loans to governments for projects in agriculture, irrigation, power, transport, water supply, education, health etc
- Provides loans for micro-businesses
- Encourages industrial development of underdeveloped countries by promoting economic reforms

## International Monetary Fund (IMF)

- Ensures **stability of international monetary system** (exchange rates and international payments that enable countries and their citizens to transact with one another)
- Maintains stability and prevents crises in the international monetary system by reviewing country policies and national, regional & global economic and financial developments through a formal system known as '**surveillance**'.
- Provides members with finance to correct balance of payments problems.
- Extended its reach in 1970s after oil-price shocks getting more involved in economic development and poverty reduction.
- To ensure repayment of loans, IMF imposed restrictions and conditions on developing countries called '**stabilisation programmes**' to achieve internal and external balance.
- IMF programmes often are free-market based – trade liberalisation, removal of state subsidies, privatisation, floating exchange rates and measures to reduce budget deficits.

## Non-government organisations (NGOs)

**NGO: Any non-profit, voluntary citizens' groups, which are organised on a local, national or international level.**

NGOs promote community-based development strategies:

- Local control of small-scale projects
- Self-reliance
- Emphasis on using the skills available
- Environmental sustainability
- Community development
- Human rights

### Role of financial markets

**Financial market:** buyers and sellers come together to trade financial assets, such as stocks, bonds, currencies, and derivatives. The main goal of a financial market is to **match buyers and sellers** to efficiently allocate financial capital to its most productive uses helping to increase economic growth

#### Key roles:

- To facilitate saving by businesses/households - secure place to store money and earn interest
- To lend to businesses/consumers
- To allocate funds to productive uses; allocate capital to where the rate of return relative to risk is highest
- To facilitate the final exchange of goods/services (e.g. contactless payment)
- To provide forward markets to allow economic agents to insure against price instability and hedge against possible risks
- To provide a market for equities, allowing business to raise new capital
- To provide information about the prices of financial assets

### Financial markets

**Money market:** short-term, highly liquid debt securities including instruments like Treasury bills, commercial paper, and certificates of deposit; includes banks, financial institutions, and corporations seeking short-term financing or investments.

**Capital market:** long-term debt and equity securities, including stocks, bonds, and real estate investments; includes primary (new issue of shares) and secondary (existing bonds/shares are traded)

**Foreign exchange market:** currencies are bought and sold; facilitates international trade and investment

### Market failure: asymmetric information

**Asymmetric Information:** one party in a transaction has more information than the other which can lead to

- **Adverse selection:** occurs when individuals with hidden information about their riskiness (e.g., borrowers with poor credit history) are more likely to seek financial products (e.g. loans), leading to higher default rates for lenders.
- **Moral hazard:** arises when one party, typically after a transaction, has an incentive to behave differently because of incomplete information e.g. borrowers may take on excessive risks if they believe they won't bear the full consequences of their actions.

### Market failure: externalities & systemic risk

**Externalities:** spillover effects that affect parties not directly involved in a transaction:

- **Negative externalities:** financial institutions may engage in risky practices (e.g., excessive lending) that can lead to **systemic risks** affecting the entire economy e.g. GFC 2008
- **Systemic risk:** widespread failure of financial institutions leading to a domino effect and a widespread economic collapse.
- **Positive externalities:** a well-functioning financial sector can benefit the broader economy by efficiently allocating capital and promoting economic growth.

### Market failure: moral hazard

**Moral hazard:** refers to the risk that one party may take on excessive risks because they believe they are protected from the full consequences of their actions.

- It can arise when banks and financial institutions believe they will be bailed out by the government in the event of a financial crisis.
- This can lead to reckless behaviour and excessive risk-taking.

**Market failure: speculation and market bubbles**

**Speculation:** buying assets (e.g. stocks or real estate) with the expectation of profiting from price increases, rather than from the asset's intrinsic value.

**Market bubbles:** when asset prices rise significantly above their fundamental values due to speculation and irrational exuberance; bubbles often burst, leading to market crashes and financial instability.

**Market failure: market rigging**

**Market rigging:** the manipulation of financial markets to gain unfair advantages.

- Examples include insider trading (trading based on non-public, material information), market manipulation (e.g., pump-and-dump schemes), and collusive behaviour among market participants to distort prices.
- Monopoly power is usually assumed to damage consumer and social welfare.
- Market rigging undermines market integrity and can lead to investor losses.

**Lack of regulation:** inadequate or ineffective regulation of financial markets can lead to excessive risk-taking, fraud, and other forms of misconduct.

**Financial crisis**

**Financial crisis:** major shock to financial markets, associated typically with falling asset prices and insolvency amongst debtors which ramifies throughout the financial system, disrupting the market's capacity to allocate financial capital.

Includes currency crisis (sudden collapse of currency), external debt crisis (unable to fund a current account deficit), sovereign debt crisis (government cannot pay interest on their debt), banking crisis (possible run-on banks) and broad financial crisis (combination of others)

**Causes of financial crisis****Financial market failures / behavioural finance**

- "Irrational exuberance" among investors
- Increased complexity arising from financial innovation
- The Minsky Hypothesis – where "financial stability breeds instability"

**Macroeconomic and financial policy failures**

- Unintended consequences of financial deregulation as a supply-side policy
- Banks too big to fail? Ever-riskier behaviour due to moral hazard
- Failures of credit ratings agencies in pricing risk accurately
- Structural changes in the global economy including economic imbalances (e.g. global savings glut and extended period of low real interest rates)

**Role of Central Bank**

**Central bank:** the monetary authority/major regulatory bank in a country responsible for **monetary policy** and **maintaining financial stability**.

E.g. Bank of England (UK), European Central Bank (ECB) for all member nations of the Euro Area, United States Federal Reserve (The Fed)

**Key roles:**

- Setting interest rates to control inflation and promote economic growth.
- Regulating banks to ensure they are financially sound and to protect depositors.
- Maintaining financial stability by acting as a **lender of last resort**, providing liquidity to financial institutions in times of crisis.
- Issuing & managing currency such operating with a managed floating exchange rate.
- Conducting research and providing advice to policymakers
- Acts as the government's bank (issues bonds, manages government debt and provides advice)

**Public spending**

**Public spending:** spending by the government to influence AD

**Current spending:** government consumption  $G$  = spending on the say-today costs of running public services e.g. wages of teachers, energy bills for hospitals; directly affects AD; does not include transfer payments

**Transfer payment:** payments made or income received in which no goods or services are being paid for, such as a benefit payment or pension

**Capital spending:** government investment in the economy's infrastructure e.g. building hospitals & housing, new roads/railways

**Factors in the changing size & composition of public spending**

**Demographics** – ageing populations increase the demand for healthcare

**Rising incomes** – public services typically have a high YED so if real incomes grow there is an increase demand for public services

**Expectations** – as technology improves, expectations of better health / education / infrastructure/wifi increase

**Times of crisis** – people expect the government to bail out banks or support businesses and jobs in a pandemic, help households with energy bills in a cost-of-living crisis etc

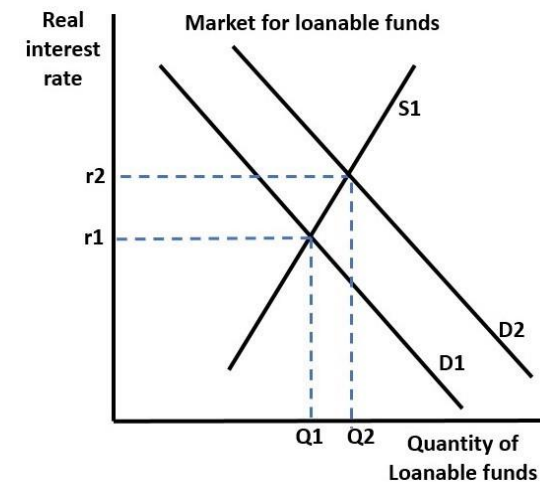
**Advantages of higher public spending as % of GDP**

- Adds to AD increasing short run growth
- Helps economy recovery from recession (with fiscal multiplier effects)
- If government invests can add to AS and long run growth
- Can 'crowd in' private sector investment if government improves transport/communications/energy networks which increase private sector's efficiency;
- Government spending on healthcare and education can also increase labour productivity in the long run
- Can help reduce income inequality and poverty
- Can help reach net zero environmental targets

**Disadvantages of higher public spending**

**Resource crowding out:** when the economy is operating at full capacity and the growth of the public sector causes a shortage of resources in the private sector

**Financial crowding out:** expansion of the state sector financed by increased government borrowing can cause an increase in demand for loanable funds ( $D1$  to  $D2$ ) which pushes up interest rates ( $r1$  to  $r2$ ) and crowds out private sector investment

**Disadvantages of higher public spending**

- Government sector is not profit-motivated, so an increasing role for the state could reduce productivity growth and economic growth
- Rising national debt – successive budget deficits increase the size of the national debt which increases the debt servicing costs (debt interest) so less is available to spend on public services
- May mean higher taxes and/or more austerity required in future
- Restricts freedom of choice – 'nanny state' - anti-free market philosophy that private sector allocated resources more efficiently
- Less government spending can ease demand-pull inflation pressures

**Impact of government spending on inequality**

- Spending on welfare benefits can help reduce poverty and inequality; caps on welfare have the opposite effect
- Low-income households tend to benefit disproportionately from public spending on housing, healthcare and education

**Taxation**

**Direct tax:** a tax on income/wealth e.g. income tax, employee NICs, corporation tax, capital gains tax

**Indirect tax:** a tax on spending e.g. VAT, excise duties

**Progressive tax:** a tax that takes a higher proportion of income from those on higher incomes

**Proportional tax:** a tax that takes the same proportion of income whatever the level of income

**Regressive tax:** a tax that takes a lower proportion of income from those on higher incomes

**Changes in direct taxes**

- Reduction in income tax and NICs – increases real disposable incomes, increases consumption, AD rises, short run economic growth, but there may be demand-pull inflation; could suck in imports causing a deterioration in the current account balance
- Lower direct taxes can increase incentives to work, save and invest
- Lower direct taxes may attract more immigration and help fill skills gaps
- Lower corporation tax increases the retained profits of businesses which could be re-invested; higher investment adds to AD with multiplier effect and LRAS.
- Lower direct taxes may encourage more entrepreneurship, R&D and innovation; increase dynamic efficiency
- Lower direct taxes could attract more FDI (less corporation tax)
- Lower direct taxes, which are usually progressive, could increase income and wealth inequality
- Lower direct taxes could reduce government revenue depending on the impact on the supply-side of the economy; higher budget deficit, National Debt could rise

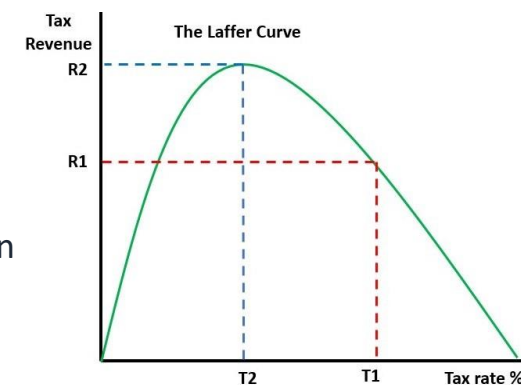
*NB: Analysis can be reversed for increases in direct taxes*

**Changes in indirect taxes**

- Reducing VAT could encourage increased spending if cost savings are passed on to consumers; could boost confidence
- Reducing excise duties on tobacco, alcohol etc. Could increase consumption of goods that have negative consumption externalities; net welfare loss
- Reducing regressive taxes would reduce income inequality
- Reducing import tariffs can boost the gains from trade but exposes businesses to more competition from abroad
- Lower indirect taxes can reduce cost-push inflation
- Lower indirect taxes can reduce shadow market activity & bootlegging
- Reducing indirect taxes may reduce government revenue and weaken public finances
- *NB: Analysis can be reversed for increases in indirect taxes*

**Laffer curve**

**Laffer Curve:** the relationship between tax rates and government revenue. At very high tax rates, people are disincentivised to work / save / invest, there may be more tax avoidance / evasion / possible brain drain, so a cut in the tax rate (T1 to T2) could generate economic growth and increase tax revenue (R1 to R2)

**Tax burden**

**Tax burden:** the total tax revenues (direct and indirect) as a percentage of GDP.

- Rising tax burden increases government revenue, helps reduce government borrowing, redistributes income/wealth (if progressive taxes are higher), allows more investment in public goods and helps address externalities
- However, it also may constrain growth, reduce disposable incomes, increase tax avoidance/evasion, reduce competitiveness and curb incentives to work

**Fiscal policy**

**Automatic stabilisers:** automatic fiscal changes as the economy moves through stages of the business cycle e.g. the fall in tax revenues during a recession or an increase in state welfare benefits when unemployment is rising; help smooth the trade cycle

**Discretionary fiscal policy:** fiscal policy decisions determined by government macroeconomic priorities

**Counter-cyclical fiscal policy:** Keynes argued fiscal policy should be expansionary in recession and contractionary in a boom.

**Fiscal (budget) deficit v national debt**

**Budget deficit or fiscal deficit:** is the annual amount the government borrows to make up the gap between its income (mostly tax revenue) and its spending. A net injections into the circular flow  $G > T$ ; it is a flow

**National debt (public sector net debt):** a stock of the total accumulation of budget deficits (government borrowing) that is still to be repaid

**Cyclical fiscal deficit:** government borrowing related to the trade cycle – in a recession government spending rises and tax revenues fall; should go when economy returns to trend growth rate

**Structural fiscal deficit:** government borrowing that remains when economy is at full capacity; tax and welfare reform may be needed

**Government borrowing v household borrowing**

Govt finances not like a household's or an individual business's finances because:

- Government decisions are big enough to influence whole economy
- Fiscal policy can, and should, be used counter-cyclically
- Governments do not 'die' so any debts can be paid off in future
- Government can borrow to invest; interest is then paid by those benefiting from the investment in future – this can be considered intergenerationally much fairer than borrowing for current spending)

**Financing government borrowing**

- If government revenue is less than government spending, it has to borrow to make up the difference
- Government issues bonds/Treasury bills = IOUs
- It has to pay interest on its debt (debt servicing costs)
- Interest on bonds is called the bond yield
- The yield on the bond varies inversely with the price of bonds
- Some bonds are index-linked (just over 25% in UK) and the interest increases payable with inflation

**Fiscal rules**

**Fiscal rules:** restrictions on fiscal policy set by the government to constrain its own decisions on spending and taxes

**UK government's main fiscal rules are:**

- National Debt should be on course to fall as a % of GDP in five years' time
- Public sector borrowing should not exceed 3% of GDP in five years' time
- Some types of welfare spending should stay below a pre-specified cap

The Eurozone's fiscal rules allow countries with excessive borrowing to reduce their debt on average by 1% per year if it is above 90% of gross domestic product (GDP), and by 0.5% per year on average if the debt pile is between 60% and 90% of GDP

**Factors influencing the size of the budget deficit and size of the National Debt**

**Budget deficit factors:**

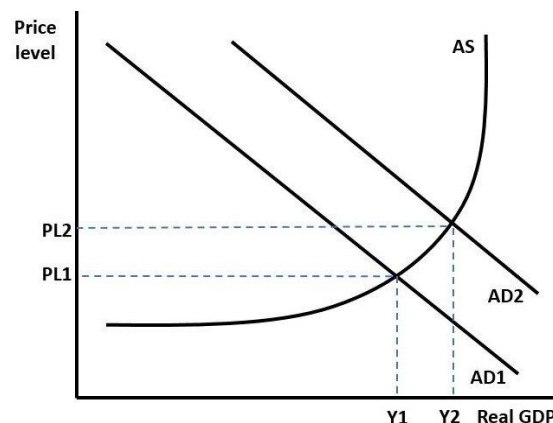
- State of the economy (cyclically part higher in recession, more spent supporting incomes & jobs, less tax revenue as more unemployed, less consumer spending, lower profits)
- State of the housing market (affects stamp duty revenues)
- Political priorities
- Unplanned events (Economic shocks, global pandemic et)

**National Debt factors:**

- Size and persistence of budget deficit (which adds to the National Debt)
- Government policy choices on tax and public spending.

### Advantages of running a budget deficit

- **Increase in economic growth:** budget deficit injects income into the circular flow ( $G > T$ ) boosting AD, with fiscal multiplier effects (AD may shift again from AD2) leading to growth and more employment in the short run
- Helps to **ease the effects of a negative economic shocks**
- If borrowing is for **capital investment** (or corporation tax cuts), higher investment can cause the AS to shift right in the long run



*A **successful fiscal stimulus generates economic growth** increasing tax revenues and reducing welfare costs. Borrowing and public sector debt as a % of GDP will start to decline with faster GDP growth*

### Disadvantages of higher budget deficit

- May be inflationary if economy is near full capacity; this may also depend on the size of the fiscal multiplier
- May increase import demand causing current account to deteriorate
- Financial crowding out/upward pressure on interest rates
- Resource crowding out
- Adds to the National Debt; higher debt servicing costs
- Intergenerationally unfair if borrowing to spend not invest
- May only be possible to reduce it with higher tax, less public spending, which is deflationary i.e. slows growth rate

### Significance of the size of the National Debt

A high debt-to-GDP ratio can create some economic problems:

- Higher bond yields as buying bonds becomes riskier for investors
- Loss of strong credit rating with credit rating agencies (harder for government to borrow in future)
- Higher debt servicing costs, leaving less government revenue for improving public services or boosting public sector investment
- May deter FDI
- If debt has accumulated from borrowing to fund current spending, this is seen to be intergenerationally unfair
- High government debt can put upward pressure on inflation

However, the degree of concern depends on multiple factors including whether the debt is owed to the country's citizens or to foreign investors, whether the central bank holds much of the debt or not (likely a generous creditor) and the time frame for when the debt needs repaying.

### Austerity debate

When governments believe their debt is at unsustainable levels, they can choose to pursue a policy of austerity:

#### For austerity:

- Reduces debt and means less tax in long run
- Stronger private sector (less crowding out)
- Avoids high debt interest costs (opportunity cost)
- Increases FDI (investors more confident)

#### Against austerity:

- Self-defeating as it slows growth
- Makes it harder to pay back debt and borrow less
- Unless bonds yields are very high, government ought to invest in economy
- Public investment projects increase AD, LRAS & growth

## Global causes of macroeconomic problems

**Global Economic Shocks:** Events such as financial crises, pandemics, geopolitical tensions, energy shocks, inflation shocks or natural disasters can create widespread economic instability, affecting various countries simultaneously.

**Global Trade Imbalances:** Persistent trade deficits or surpluses can disrupt global markets, leading to currency fluctuations; deficit countries may adopt protectionist measures or engage in trade conflicts affecting economic growth and stability.

**Financial Market Volatility** generates uncertainty, reducing investor confidence, and potentially triggering broader economic downturns e.g. GFC

**Income Inequality from globalisation** can undermine social cohesion and consumer demand within economies, reducing economic activity and limiting opportunities for sustainable growth.

**Climate change:** resource depletion, and environmental degradation pose significant risks to economies, affecting sectors such as agriculture, energy, and manufacturing, and necessitating costly adaptation and mitigation measures.

**Technological Disruptions:** while beneficial in the long term, new tech can disrupt traditional industries, leading to job displacement, income inequality, and structural adjustments that may strain economic stability in the short term.

**Demographic Changes:** Aging populations, declining birth rates, and migration patterns can impact labour force participation, productivity levels, and government spending on healthcare and pension systems, posing challenges for economic growth and sustainability.

## Limitations of macroeconomic policies in this global context

Macroeconomic policies may be well-selected by governments yet fail to achieve their aims because of... global interconnectedness, global supply chains, cross-border capital flows, migration, trade dependencies, trading blocs/agreements, international institutions & agreements, global economic uncertainty, exchange rate movements...

*Governments often need to adopt a holistic approach to macroeconomic policymaking that considers both domestic and global factors*

## Fiscal policy in the global context

**Keynesian economics** emphasises the use of fiscal policy to address short-term fluctuations in aggregate demand stabilise the economy and reach full employment. After the GFC, fiscal stimulus policies were used to promote economic recovery

**Monetarist economics** favours a more hands-off approach to fiscal policy and places greater emphasis on the role of monetary policy in influencing economic outcomes. They argue discretionary fiscal policy is not as effective because it can lead to unintended consequences, such as inflation or crowding out private investment.

- Changes in taxes/benefits/public service provision can affect the direction of labour migration

## Monetary policy in the global context

- Interest rate changes in one country impact the relative risk-to-rate of return and influence the direction of global capital and savings flows
- Quantitative easing can increase the size of the money supply and could become inflationary; relative inflation rates impact on international competitiveness
- Intervention to manipulate/adjust/fix a currency's value can affect trade and international competitiveness
- Monetarists believe control of the money supply helps ensure macro stability, but it is hard to measure it
- Inflation is harder to control as countries are more global interconnected

## Supply-side policies in the global context

Supply-side policies aim to increase the productive potential of an economy (LRAS rises, PPF shifts outwards)

- SSPs are often very important for countries trying to develop more effectively
- However, for a country to reap the full gains from its SSPs, it needs to be doing more of them or do them better to see a rise in relative productivity, growth & development