Characteristics of Developing Economies

- Economies that belong to same income category might be very different from each other in terms of their development but there are certain characteristics that are generally shared among developing economies.

Characteristics of Developing Economies

- Poor and limited educational and health care services, poor quality infrastructure (including roads, railway network), high proportion of population living in absolute poverty and high national debt etc are some of the characteristics that are common in majority of developing economies.

International Debt

- Due to persistent budget deficit and balance of payments deficits, developing economies often suffer from international debt related problems. This debt is either raised from foreign economies or from international development organizations including World Bank and International Monetary Fund (IMF).

International Debt

- The proportion of national income that is on average used to service international debt is used to gauge economies' extent of international indebtedness.
- Higher the economies' indebtedness, lower proportion of government revenue will be available for financing developmental projects since major chunk will be utilized to pay back international debt.

Population Structures of Developed and Developing Economies

- Unlike developed economies' populations that are generally ageing over time, large proportions of developing economies' populations are found to lie in lower age brackets which is known as young population.
- This is because of relatively higher birth rates of developing economies as compared with developed economies.

Population Structures of Developed and Developing Economies

- **Hidden Momentum of Population Growth:** Hence even in presence of population control measures in developing countries their population levels will rise for first few years before they eventually start to fall.

Population Structures of Developed and Developing Economies

- Unlike developed economies where most of dependent population lies in higher age brackets also known as economically inactive population, developing economies have high dependency ratios because of large number of young citizens.

Population Structures of Developed and Developing Economies

Dependency Ratio = Total Population / People Employed

- The formula above calculates average number of people that are supported by a typical employed citizen of an economy.

Population Structures of Developed and Developing Economies

- Child labor is inevitable consequence of high birth rates of developing economies.
- Higher an economy's working age population proportion in its total population, lower will be its dependency ratio.
- Policymakers should be mindful of changes in economies' population structures and should devise appropriate policies to best use this resource.

Population Structures of Developed and Developing Economies

- For instance developing economies should invest in labor intensive industries so benefit from large number of young citizens and to exploit economy's comparative advantage.
- Similarly developed economies can combat ageing population through higher birth rates. Higher birth can be encouraged through higher social security payments to larger families.

Optimum Population Size

- Since human resource is any economy's one of the factors of production, optimum level of economies' population will be one that makes them maximize their output per head for given level of other factors of production.

Optimum Population Size

- Based upon this idea, under-populated economies are defined as ones that can increase their output per head through higher population levels. Higher population levels of such economies will make them better utilize their other factor endowments. On the other hand, over-populated economies are defined as those that are experiencing diminishing returns to human inputs.

Unequal Income Distribution

- Income distribution is generally quite unequal in developing economies. This is because of limited availability of necessary facilities that are important for materialistic growth of less-privileged segments of society.
- Poor provision of public education, health care and unequal access to capital are major reasons behind seclusion of certain segments from economy's growth.

Unequal Income Distribution

- Previously, many economists were of the opinion that sustainable growth of low income countries will help them improve their all citizens' materialistic well-being.

  This is known as "trickle-down effect". However recently historical data has shown that many high growth economies have performed miserably with regards to ensuring provision of decent living standards for all of its citizens. Hence policymakers are mindful of fact that apart from generation of more economic opportunities they should also ensure their more equal distribution.

Unemployment in Developing Economies

- Limited growth of employment opportunities with regards to increase in economies' population levels result in high unemployment levels of developing economies. Lower stock of other factors of production is often primary reason behind economies' low growth of employment opportunities.

Unemployment in Developing Economies

- However if economies use appropriate strategies to exploit their human resource potential then high population levels might not prove to be a major challenge for their development.

Unemployment in Developing Economies

- Exploitation of comparative advantage through usage of labor intensive techniques can help developing economies produce cheaper goods which in result can make them earn higher export revenue because of their products' increased price competitiveness.

International Trade

- Too much reliance on export of primary goods for export revenue is major challenge for low income countries to boost their economic growth.
- Low price elasticity of demand for primary goods mean that during times of falling prices (of primary goods) their export revenue will be low.

International Trade

- Moreover low income elasticity of demand mean that during times of rising global income levels increase in quantity demanded for primary products will not be huge. This is why many developing economies do not benefit much from growth of national income of foreign economies.

International Trade

- Hence ideally developing economies should try diversifying their exports to reduce their risk of export revenue fluctuations that arise from too much reliance from export of few goods/services.
- Greater production and export of value-added goods can result in higher export revenue for developing economies.

International Trade

- Newly Industrializing Economies (NIEs) including India, China along with other East Asian Economies have high proportion of manufactured goods in their overall exports which makes them earn much higher export revenue as compared to other developing economies.

Urbanization

- Unlike developed economies where high percentage of total population lives in urban centers, in developing economies still large proportion of population lives in rural areas and relies on subsistence farming/agriculture for their survival. Limited commercial activities in rural areas often result in lower living standards of rural population.

Urbanization

- This is why governments of developing countries are often found initiating and implementing policies to increase general income levels of rural population. Export subsidies and imposition of minimum prices on agricultural goods and provision of financial and technical assistance for commercial sale of agricultural output are some of the potential strategies used to improve rural population's living standards.

Technology

- Technology plays a vital role in any economy's development. Due to limited savings of developing economies they are often unable to adequately investment in research and development that is needed to improve upon their current state of technology.

Technology

- This concept is known as Vicious Circle of Poverty which refers to the idea that lower national income poses constraint for economies to achieve higher future income levels. Lower savings due to lower national income result in lower amounts being channelized into investments. Hence lower research and development will result in lower capital stock that restraints improvement of economies' productive potential.

Factors affecting economies' Potential Growth

- Unlike economies' actual growth that is calculated through percentage changes in their real GDP/GNP figures, potential growth refers to improvements in economies' maximum production potential. This is represented through changes in their Production Possibility Curves (PPCs).

Factors affecting economies' Potential Growth

- Outward shifts in economies' PPC depict their enhanced production potential and vice versa. Whether they are able to exploit this higher production potential is subject to their aggregate demand levels.
- Improvements in economies' factor endowments either in terms of higher quantity and/or improved quality will positively affect their potential growth rates.

Improvement in Economies' Factor Endowments

- Capital: higher investment is needed to increase quantity and improve quality of economies' stock of capital goods. Higher aggregate savings need to be channelized into potential investment opportunities to improve economies' stock of capital goods.

Improvement in Economies' Factor Endowments

- Lower savings of low income economies significantly limit their ability to achieve high investment levels. Reliance on international borrowing and international trade might be effective strategy for developing economies to improve their initial stock of capital goods.

Improvement in Economies' Factor Endowments

- Land: though countries can not increase physical land available to them but they can definitely try increasing its productivity. Use of better quality capital goods like high quality fertilizers / insecticides is expected to improve agricultural land's productivity. Similarly greater extraction of mineral resources will cause economies' PPC to shift outwards.

Improvement in Economies' Factor Endowments

- Careful use of non-renewable natural resources is necessary to ensure that higher current living standards do not adversely affect future generations' living standards. Hence conservation of natural resources is important for countries' sustainable growth.

Improvement in Economies' Factor Endowments

Human Capital: an economy can improve its human capital with provision of better quality educational and health care services.

- Access to basic necessities of life including education and health care services apart from being citizens' constitutional right is also necessary to improve their productivity.
- Moreover corrective actions are needed to achieve favorable changes in economy's population structure which can in result improve countries' human resource potential.

Improvement in Economies' Factor Endowments

- For instance lower birth rates through use of population control measures will keep economies' dependency ratio low. Similarly generation of adequate employment opportunities to accommodate all individuals who are willing and able to work will allow countries to make better use of their human resource.

Improvement in Economies' Factor Endowments

- **Enterprise:** access to capital and economic incentives for increased investment are significant determinants of economies' level of entrepreneurship.
- Higher investment in research and development is also necessary to improve economies' current state of technology.

Improvement in Economies' Factor Endowments

- Due to lower aggregate savings of developing economies they are unable to undertake adequate investment in research and development and therefore might need to rely on reverse engineering for initial phases of technological advancements. However reliance on international borrowing, if used effectively, can prove beneficial.

International Development Organizations

- World Bank or International Bank for Reconstruction and Development (IBRD) as it was formerly known and International Monetary Fund also known as IMF were established at the end of Bretton Woods Conference by the end of World War II in 1944.

International Development Organizations

- World Bank and IMF finance developing economies for specific projects and purposes. Unlike IMF that focuses on financing economies struggling from Balance of Payments deficits, World Bank primarily focuses on providing developmental loans and aids to poor / developing economies.

International Monetary Fund

- IMF issues loan to economies struggling with Balance of Payments disequilibrium.
- Countries suffering from persistent BOP deficits are expected to experience exchange rate depreciation due to their currencies reduced demand on international markets. To prevent excessive cost-push inflation that is inevitable consequence of economy's expensive imports requires improvement of economy's exchange rate.

International Monetary Fund

- Sufficient amounts of foreign currency reserves are needed to artificially increase currency's demand to stabilize economy's exchange rate. Lack of foreign currency reserves require developing economies to rely on international financing options to stabilize their economies' exchange rates.

World Bank

- Though development of developing economies is World Bank's one of the key priorities but often their finance is not free of charge.
- Proponents of this strategy claim that interest-free loans or aids might not compel beneficiaries to make the most productive use of developmental grants.

World Bank

- However some critics of World Bank claim that its stringent requirements for economies to qualify for developmental loans and its strict loan usage policies significantly affect economies' ability to benefit from such developmental loans / grants.

World Bank: Specialization Areas

- Though World Bank unlike IMF has much wider development scope but there are certain priority areas / sectors that are more heavily financed by World Bank that other sectors / areas which include:

1. Agriculture and Rural Development
2. Access to clean drinking water and sanitation
3. Environmental Protection
4. Health and Education
5. Infrastructure Development
6. Governance: research to improve institutional framework of developing economies

Criticism of World Bank

As mentioned earlier, World Bank's excessive requirements concerning implementation of various structural and institutional framework limits economies' ability to make most productive use of developmental loans.

- Moreover World Bank's forces loan recipient countries to undertake certain structural changes which are not best aligned with these countries factor endowments and state of technology.

International Trade and Development

- Though economic theory supports the idea of international trade because trade can be huge stimulus for growth and development but some people are skeptical about the benefits of international trade especially for developing countries.

International Trade and Development

- Given the recent pattern of international trade where developed economies have to a large extent monopolized international markets for more value-added products including high technology manufactured goods and services; developing economies being primarily dependent upon export of primary goods, export revenue varies significantly across countries and this has made some economists question the acclaimed benefits of international trade.

Benefits of International Trade

1. Improvement of supply-side conditions of developing economies:

- Transfer of technology and capital goods from developed to developing economies
- Benefit from economies of scale because of ability to cater to larger international markets
- Increased international competition forces domestic producers of developing countries to become more competitive through product and process innovation

Benefits of International Trade

- Increased aggregate savings resulting from higher national income that arises from economies' engagement in international trade

2. Improvement of demand conditions by ensuring availability of cheap and high quality imported goods / services

International Trade and Development

- At present, developing economies' exports are a small proportion of total global exports and huge proportion of their national income is spent on cheaper foreign products.

- Moreover well-established foreign firms have significantly constrained growth of infant industries –newly emerging industries – of developing economies. Some protectionism is needed to ensure their survival at least in the initial few years.

Developing Countries Challenges related to International Trade

1. Low income elasticity of demand for primary products do not significantly increase their quantity demanded during times of higher global income levels. On the other hand, manufactured goods generally experience significant increase in their demand levels due to their high income elasticity of demand.

Developing Countries Challenges related to International Trade

- Moreover, presence of better quality enterprise / businesses in developed economies make them capture bigger share of global markets. Moreover, profits of multinationals are often remitted back to their host economies instead of being reinvested in local economy.

Developing Countries Challenges related to International Trade

- Recently a lot of developing economies including China, India, Brazil etc have started specializing in production of manufactured goods and that has significantly helped them to increase their export share in international markets.

Developing Countries Challenges related to International Trade

- Except for African economies for which export of primary products still constitute more than 80% of their total exports; all other developing economies have now much lower reliance on primary products as much they had in the past.