DP IB Economics: SL

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4.9 Barriers to Economic Growth & Development

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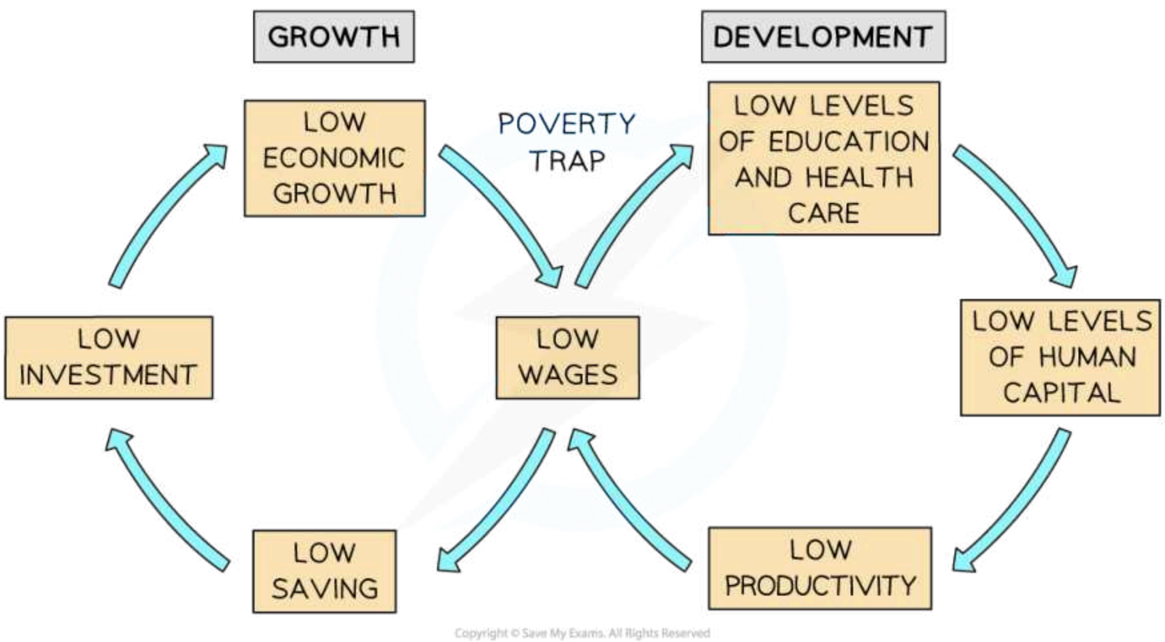
4.9.1 Poverty Traps

Understanding Poverty Trap

- There are many **causes of poverty.** However, poor countries have several **common characteristics** which can be summarised in a **poverty cycle diagram**



Poverty is caused by a lack of both economic growth and human development

Development

- **Low wages:** represent the intersection of economic growth and human development and are the major cause of poverty
  - Low wages are usually the result of **unemployment**, **informal employment**, a lack of skills, or a **primary sector** based economy

- **Low levels of education and healthcare:** cost money and with lower wage levels these are not accessible
  - People find it harder to stay well or to **recover from illness**

- **Low levels of human capital:** low education and healthcare lead to low levels of **human capital**, which reduces productivity

- **Low productivity:** results in low wages and the cycle continues

Growth

- **Low wages:** represent the intersection of economic growth and human development and are the major cause of poverty
- **Low saving:** with low wage levels it is much harder to save as any money is spent on necessities
- **Low investment:** savings drive investment as firms are able to borrow money from commercial banks. Low levels of savings mean that banks have less money available for investment
- **Low economic growth:** low levels of investment hold back productivity and **economic growth**

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4.9.2 Economic, Political & Social Barriers

Types of Economic Barriers

Economic Factors that Influence Growth & Development

Factor	Explanation

Dependency on the primary sector	▪ In 2022 copper exports from Zambia accounted for 70% of their total exports & **primary products** in excess of 90%. They are suffering from over-specialisation
	▪ Primary products tend to have a very low-income **elasticity of demand (YED).** As world income rises, there is a less-than-proportional increase in demand
	    ▪ This means that there is limited scope to continue increasing demand
	▪ Primary products have very little **added value**
	    ▪ Exporting **manufactured products** raises the added value, income & profits
	▪ Due to the inelastic nature of both the demand & supply of **commodities**, small changes in demand or supply can lead to large changes in price, meaning that prices can be volatile
	    ▪ When commodity prices rise, **GDP rises** - & vice versa

Rising income inequality	▪ A **more equal distribution** of income means that more households are able to consume a wider range of goods ▪ Economies with a smaller **medium-income band** face less consumption which leads to less aggregate demand and less economic growth ▪ Rising income inequality worsens the problem as the rich get richer and the poor, **relatively poorer**
Lack of access to international markets	▪ **International trade** is a significant source of economic growth and higher incomes, leading to economic development

	▪ Many countries **cannot access** more economically developed markets due to the trade barriers put in place by developed economies to protect their firms ▪ The **World Trade Organisation (WTO)** aims to increase **trade liberalisation** so as to improve access for all countries
Informal economy	▪ Workers in the **informal economy** are not taxed on their wages ▪ The **lack of tax revenue** reduces the provision of infrastructure, merit and public goods ▪ Many developing countries have a larger informal than the formal economy
Capital flight	▪ Occurs when money or assets **rapidly leave** a country ▪ This may happen due to political upheaval, economic sanctions, war, or changes to government policy (e.g. interest rates) ▪ Sanctions applied to Russia in 2022 resulted in $75 billion of **capital outflows** ▪ Capital flight reduces the money available for **investment,** reducing growth & development
Indebtedness	▪ The higher the level of borrowing from institutions like the **International Monetary Fund (IMF)**, the higher the monthly repayments ▪ Repaying debt reduces the money available for investment and expenditure on merit and public goods ▪ The higher the debt the worse the **potential economic growth**
Lack of access to infrastructure & appropriate technology	▪ Good **infrastructure reduces business costs** & attracts foreign direct investment ▪ Some developing countries have such **poor infrastructure** which makes it difficult to generate economic activity ▪ This is one reason why China has invested so heavily in infrastructure projects in Asia & Africa as it unlocks **economic potential**

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Low levels of human capital	▪ Low levels of education and healthcare reduce productivity ▪ Investing in **supply-side policy** to improve health and education increases the potential output of the country (shifts the **production possibility frontier** outwards) ▪ Higher education/skill levels → higher human capital → increased productivity → higher output → higher economic growth → higher income
Geography including landlocked countries	▪ Geographic features can limit economic growth ▪ **Landlocked countries** find it harder/more expensive to import and export products (shipping freight is much cheaper than air freight) ▪ Natural features such as **deserts** reduce the quantity of **productive land** that can be used to generate output and economic growth
Tropical climates and endemic diseases	▪ Tropical climates are often associated with **debilitating diseases** such as malaria or dengue ▪ These reduce the **productivity** and output of the workforce and limit/reduce economic growth

Types of Political & Social Barriers

- Aside from the economic factors discussed above, a range of non-economic factors can have significant influences on economic growth & development

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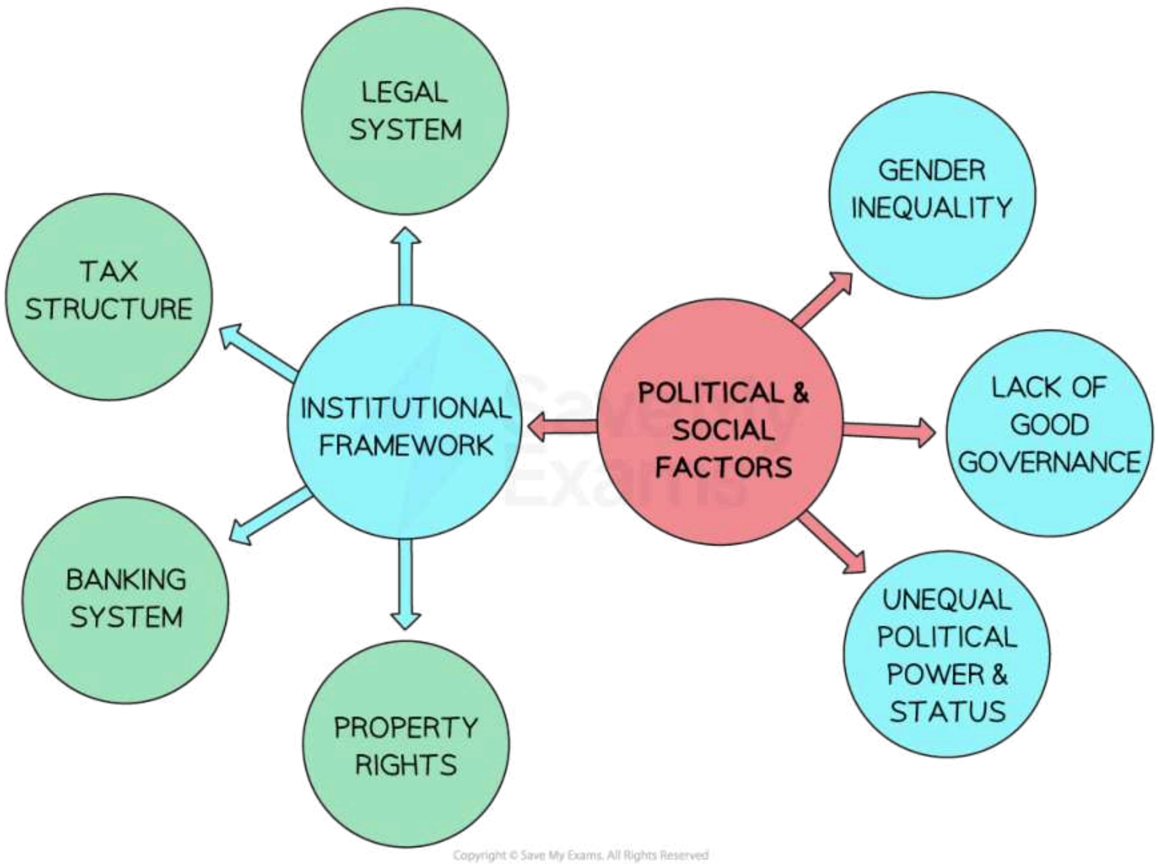

Political & social factors which hinder growth & development

The institutional framework

- This refers to the **functions of government** including the legal system, law enforcement, banking, tax structures and property rights

Legal system	▪ A strong legal system **builds confidence** in an economy ▪ Legal institutions help to create boundaries that households and firms can operate within ▪ This certainty attracts **overseas investment** ▪ This certainty helps to make **business easier** to conduct leading to higher economic growth
Tax structure	▪ A **progressive tax system** redistributes from those with higher income to those with lower income & reduces **income inequality** ▪ Sometimes the benefits of a good **progressive tax** system are eradicated by weak tax collection and tax enforcement
Banking system	▪ Lack of access to **credit and banking** limits economic growth ▪ Financial institutions enable individuals & firms to **borrow money** which can be used for investment or to generate growth ▪ A lack of financial institutions prevents this from happening
Property rights	▪ In many countries, the property is the main household **asset** which can be used to secure loans or generate income ▪ A lack of property rights in some **developing countries** prevents this from happening

Lack of good governance

- Leads to inefficient use of resources & poor decision-making. It may also result in laws/regulation which directly inhibits growth & development
- Often money intended for investment is siphoned off by corrupt politicians resulting in a lower level of investment. Corruption also **diverts funds** to certain groups who have bribed or lobbied officials (e.g. multinational firms) resulting in projects that deliver a **low level of growth & development**

Unequal political power & status

- Countries with strong **trade union** membership provide workers with more power and higher levels of income

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- With low trade union membership, the **exploitation** of workers through low wages is easier and income inequality is worse
- Countries with a class system are less incentivised to increase economic growth and development in such a way that it removes the class barriers. This limits growth and development

Gender inequality

- Gender, race or **any other discrimination** increases income inequality in an economy leading to lower levels of economic growth
- Gender inequality **reduces the incentive** for women to work and this can mean a loss of productivity to an economy, leading to lower economic growth

Evaluating Barriers to Growth & Development

- There are a **common set of factors** which prohibit economic growth and development, however, each country is unique and is likely to have a different combination of factors which are more prominent
- Understanding **the context** of the country is vital to evaluating how significant the barrier to economic growth is
  - E.g. Romania has a **history of corruption** which has reduced its development significantly when compared to other Eastern European countries
  - E.g. India has had **infrastructure problems** (old rail systems and poor roads) which have limited its ability to grow. To address this weakness, significant government investment has been taking place over the past 10 years and the economy is responding well
  - E.g. Malawi is a landlocked country whose exports are primarily agricultural. Agriculture accounts for 30% of its GDP and the cost of export is higher for a landlocked country. This reduces profits and limits economic growth.

Examiner Tips and Tricks

The data response in paper will frequently have extracts which paint a picture of a developing economy. As you read through the data, think about the **economic, political and social barriers** to development and growth and seek to identify which ones seem to be most prominent in the extracts presented. Reading with this focus helps you to evaluate the context as you assimilate the information and puts you in a better position to answer the questions which follow.