

Factors Influencing Growth and Development

Economic growth and economic development are closely linked. Higher economic growth can increase incomes, employment and tax revenues, giving governments more resources to improve healthcare, education and infrastructure.

Economic Factors

Primary Product Dependency

Primary products are raw materials and commodities such as oil, copper, gold and agricultural products. Many developing countries are heavily dependent on exporting primary products.

For example, around **90% of the Democratic Republic of Congo's exports are extracted commodities**, including copper, tin and gold.

Heavy dependence on primary products makes economies vulnerable to external shocks i.e price crashes .

Low Income Elasticity of Demand

Primary products tend to have a **low income elasticity of demand (YED)** because many are necessities. As global incomes rise, demand for primary products therefore increases by a relatively small amount.

Manufactured goods and services generally have a higher YED.

Global incomes $\uparrow \rightarrow$ demand for manufactured goods/services $\uparrow$ significantly $\rightarrow$ demand for primary products $\uparrow$ relatively slowly $\rightarrow$ export revenue growth $\downarrow \rightarrow$ economic growth restricted

This is linked to the **Prebisch-Singer hypothesis**, which argues that the price of primary commodities tends to fall relative to manufactured goods over time.

Developing countries dependent on primary exports may therefore experience worsening export revenues and slower economic growth.

Primary products also tend to have relatively little **added value** compared with manufactured goods. Moving into manufacturing can increase the value of exports, incomes and profits. For example unprocessed coffee beans sell for around **\$1/kg**, while processed coffee can sell for **\$50+/kg**.

Resource Curse / Dutch disease

A country discovers large natural resources and exports larger quantities of them → Oil exports ↑ → demand for domestic currency ↑ → currency appreciates → other exports become more expensive → international competitiveness ↓ → demand for other exports ↓ → restricting the development of other industries.

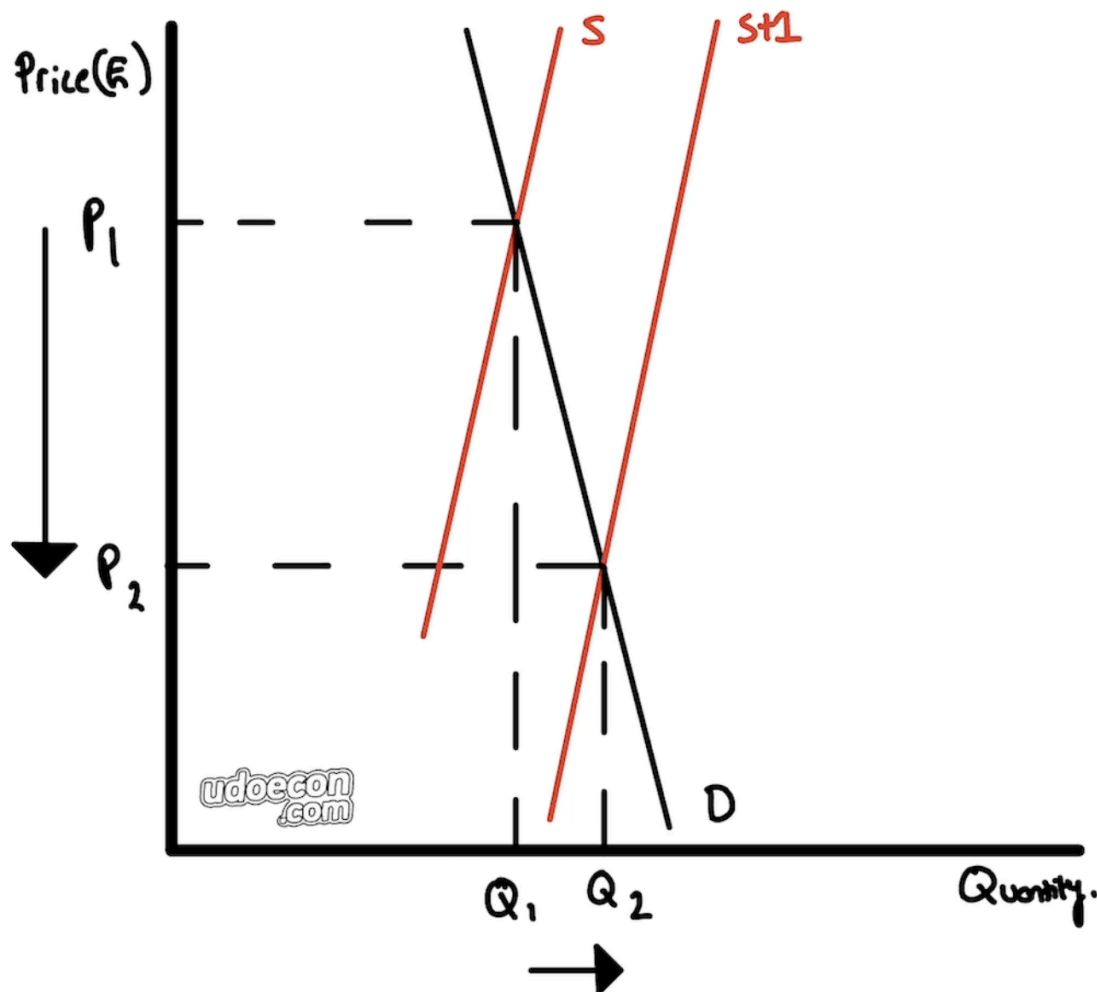
Therefore, although natural resources can generate significant export revenues, excessive dependence on them can restrict the development of other industries.

Volatility of Commodity Prices

Primary commodities often have **price inelastic demand and supply**. Demand is inelastic because many commodities are necessities, while supply can be inelastic because increasing production or discovering new resources takes time.

Small change in demand/supply → large change in commodity prices → export revenues become volatile → uncertainty ↑ → firms find it harder to plan → investment ↓ → economic growth ↓

This is particularly damaging when an economy is highly dependent on commodities. For example, commodities accounted for around **60% of Bolivia's exports**, meaning changes in commodity prices can have a significant effect on GDP.



Savings Gap: Harrod-Domar Model

A **savings gap** occurs when domestic savings are too low to finance the investment required for sustained economic growth.

The **Harrod-Domar model** argues that higher savings allow greater investment and therefore greater accumulation of capital.

Savings $\uparrow$ $\rightarrow$ funds available for investment $\uparrow$ $\rightarrow$ investment $\uparrow$ $\rightarrow$ productivity $\uparrow$ $\rightarrow$ productive capacity $\uparrow$ $\rightarrow$ LRAS shifts right $\rightarrow$ real GDP $\uparrow$ $\rightarrow$ economic growth $\uparrow$

Growth can then raise incomes, allowing households to save more and creating a positive cycle:

Higher savings $\rightarrow$ higher investment $\rightarrow$ higher economic growth $\rightarrow$ higher incomes $\rightarrow$ higher savings

The opposite can create a **poverty cycle** in developing economies:

Low incomes → low savings → low investment → limited capital accumulation → low productivity → low economic growth → low incomes

Investment is also a component of AD. Therefore, lower investment reduces both aggregate demand and the economy's long-run productive potential.

Foreign Currency Gap

A **foreign currency gap** occurs when a country does not have enough foreign currency to pay for necessary imports or international obligations.

It may be caused by:

- Low export revenues
- Rising prices of essential imports such as oil
- Large foreign debt repayments
- Capital flight

A shortage of foreign currency can restrict both growth and development.

Foreign currency shortage → ability to import ↓ → imports of food, energy, machinery and other inputs ↓ → productive capacity and living standards ↓

It can also make it harder for governments to repay foreign denominated debt. Defaulting on debt can reduce a country's **credit rating**, making international borrowing more difficult and expensive in the future.

Capital Flight

Capital flight occurs when money and assets rapidly leave a country.

This may happen because of political instability, war etc .

Political/economic uncertainty ↑ → investors move capital abroad → funds available for domestic investment ↓ → investment ↓ → AD ↓ + capital accumulation ↓ → economic growth and development ↓

Capital flight can therefore reinforce existing development problems by reducing the investment available for infrastructure, businesses and productive capacity.

Demographic Factors

The structure and growth of a country's population can influence economic growth and development.

A **high dependency ratio** means a relatively large proportion of the population is economically dependent on the working population. This can reduce the income available for savings and investment.

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An ageing population can also place pressure on government finances:

Ageing population → labour force ↓ → income tax revenue ↓ + pension/healthcare spending ↑ → less government funding available for infrastructure and education

Debt

High levels of government debt can restrict development because governments must devote more revenue towards **debt interest repayments**.

High household debt can also reduce consumption and make households more vulnerable to economic shocks.

For example total UK household debt stands at nearly £1.9 Trillion .

Access to Credit and Banking

Financial institutions allow households and firms to borrow money to finance consumption and investment. Limited access to banking can therefore restrict economic growth.

Borrowers in developing economies may have:

- No established credit history
- Little collateral (Due to lack of property rights)
- Limited access to financial institutions

This makes lending riskier.

Higher lending risk → supply of loans ↓ + interest rates ↑ → borrowing ↓ → consumption and investment ↓ → AD ↓ → economic growth ↓

Lower investment also limits capital accumulation and productivity growth, restricting the expansion of LRAS.

Microfinance can reduce this barrier by giving low-income households and small businesses greater access to credit.

Infrastructure

Good infrastructure reduces business costs, improves connectivity and can attract **foreign direct investment (FDI)**. Poor infrastructure does the opposite.

For example, less than 15% of the total roads in **Madagascar** are paved. Poor transport infrastructure can increase journey times and reduce the number of jobs workers can realistically access.

Poor infrastructure → transport/business costs ↑ → geographical mobility of labour ↓ → worker-job matching worsens → productivity ↓ → LRAS ↓ → economic growth ↓

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Poor infrastructure can therefore affect both growth and development by reducing productive efficiency while also lowering quality of life.

Education and Skills

Education increases **human capital** by improving the skills and productivity of workers.

Education and skills $\uparrow \rightarrow$ human capital $\uparrow \rightarrow$ labour productivity $\uparrow \rightarrow$ productive capacity $\uparrow \rightarrow$ LRAS shifts right / PPF shifts outwards $\rightarrow$ real GDP $\uparrow \rightarrow$ incomes $\uparrow$

Low levels of education therefore restrict economic growth by keeping labour productivity low.

Lower productivity can also reduce workers' **marginal revenue product**, contributing to lower wages and greater poverty. Education therefore influences both economic growth and development.

Absence of Property Rights

Property rights provide legal protection over assets such as land and homes.

Without secure property rights, individuals face a greater risk that their assets or returns from investment could be taken from them. This reduces the expected return from investment.

Weak property rights $\rightarrow$ investment becomes riskier $\rightarrow$ domestic investment + FDI $\downarrow \rightarrow$ AD $\downarrow$ + capital accumulation $\downarrow \rightarrow$ LRAS $\downarrow \rightarrow$ economic growth $\downarrow$

Property rights also matter because property can be used as **collateral** to secure loans. Weak property rights can therefore make it harder for households and businesses to access finance.

For example in Peru where historically over 70% of urban households lacked legal titles / property rights.

Non-Economic Factors

Corruption and Poor Governance

Corruption occurs when political or economic power is abused for private benefit. It can restrict development by diverting money away from investment.

Corruption $\uparrow \rightarrow$ government funds misallocated/stolen $\rightarrow$ investment $\downarrow \rightarrow$ infrastructure and education provision $\downarrow \rightarrow$ productivity $\downarrow \rightarrow$ economic growth $\downarrow$

Poor governance more generally can lead to inefficient resource allocation, weak decision-making and laws or regulations that discourage economic activity.

For example the US suspended **\$21 million in health sector aid to Kenya** specifically citing government corruption for the reason .

Conflict

War can destroy physical and human capital, damage infrastructure and disrupt supply chains.

Conflict → infrastructure/capital destroyed → productive capacity ↓ → LRAS shifts left → economic growth ↓

For example due to the Russia/Ukraine war the IMF estimates it caused Ukraine's real GDP to drop nearly 30% , destroying over \$150 billion of infrastructure.

Geography

Geographical characteristics can make economic growth and development more difficult.

Landlocked countries have no direct access to the sea. Exports may have to pass through neighbouring countries before reaching international ports, increasing transport and administration costs.

Landlocked → transport costs ↑ → costs of production ↑ → international competitiveness ↓
→ exports ↓ → AD ↓ → economic growth ↓