Barriers to Economic Growth/Development

Aims: By the end of this chapter, you should be able to

1. list the barriers to economic growth and development,
2. define the various measures of poverty,
3. produce and discuss the poverty cycle as a barrier to growth and development, and
4. discuss social and cultural factors as barrier to growth and development.

Introduction

- 1970-98
  i. 75% of developing countries recorded slower per capita income growth than that in Developed Countries.
  ii. Per capita income fell in 32 countries in the sample, only 7 grew fast enough to catch up (converge) with the Developed Countries.
  iii. Less than 10% of population in developing countries live in countries where average income decline. This was because the two most populous countries India and China experienced income growth per capita of 2.75% and 7% in this period respectively.

- 1987-
  i. The percentage of population in developing countries living under USD1 per day declined from 30% to 24% (largely reflecting reduction in East Asia and in a lesser extent South Asia). Excluding China which was successful in poverty reduction, the number of people living on less than $1 a day increased from 916 million in 1990 to 936 million in 1999. The total figure stood at 1.2 -1.3 billion people in 2000. 93 percent of extreme poor people in 2001 lived in three regions: East Asia, South Asia and Sub-Saharan Africa (Jeffrey Sachs in the End of Poverty, 21).
  ii. 986 million people suffered from extreme poverty in 2007 but the figure stood at 1.4 billion in 2005 using a new measure of USD 1.25 per day at 2005 PPP (The Economist, 28 August 2008).

Overview: Barriers to Economic growth/development.

1. **Poverty cycle**: low income ⇒ low savings ⇒ low investment ⇒ low income
   i. **Ineffective tax structure** that does not encourage investment, trade, work, etc.
   ii. **Lack of property rights.** No incentive to invest as you may not own or protect your investment later.
   iii. **Political instability.** Not a great place to do business because you may not able to protect your investment and keep your profit.
   v. **Unequal distribution of income.**
   vi. **Formal or informal markets.**

2. **Institutional and Political factors**: (refer back to Institutional Factors in Sources of Development.)
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3. **International Trade Barriers:**
   i. **Overdependence on primary goods.**
      If a country depends heavily of primary goods like coffee beans or coal then the growth of
this economy will depend heavily on the supply and demand of these goods by its trading partners.

ii. **Consequences of adverse terms of trade.**
   Refer to Notes on Terms of Trade and see Prebish-Singer Thesis.

iii. **Consequences of a narrow range of exports.**
   In this case, the health of the economy depends heavily on the elasticity of demand of these narrow range of exports (not necessary primary goods, this could be a range of electronic appliances like radio and tv) by its trading partners. The economy is also exposed to supply shock.

iv. **Protectionism in international trade.**
   (Learn more about Trade issue at World Bank [http://youthink.worldbank.org/issues/trade](http://youthink.worldbank.org/issues/trade))

4. **International Financial Barriers:**
   i. **Indebtedness.** (Learn more about Gender issue at World Bank [http://youthink.worldbank.org/issues/debt-relief](http://youthink.worldbank.org/issues/debt-relief))
   ii. **Capital flight.**
   iii. **Non-convertible currencies.** This basically makes it more difficult to carry out international trade. Moreover, if local currency cannot be converted then this will also discourage foreign investment as profits cannot be taken out of the country.

5. **Social & Cultural factors:** (refer back to Social versus Cultural factors in Sources of Development & Gunnar Myrdal's list of modernization.)
   i. religion
   ii. culture
   iii. tradition

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It is important to be aware that some of these factors only affect economic growth and others like lack of infrastructure are barriers to both economic growth and development. Thus, when discussing the lack of development in a developing country we have to restrict ourselves to barriers to economic development because not all barriers to economic growth are also barriers to development.

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The World Bank estimates that USD1.08 per day per person measured in 1993 PPP is required to meet basic needs. Furthermore, there are 1.1 billion people lived below the USD 1.08 level as of 2001 with an average income of only USD0.77 per day according to the World Bank. There are various measures of poverty.

i. **Absolute poverty:** This is the amount needed by a person or family to purchase the absolute minimum basic necessity like food (in terms of calories), clothing and shelter. Also defined as the percentage of population in a country who are living under the poverty line which is often defined in terms of some internationally comparable monetary measures (say at USD1 per person per day at PPP or USD2 per person per day at PPP). See table1. Actually the USD 1 per person per day at PPP and USD2 per person per day at PPP were defined in 1985 prices the equivalent in 1993 prices were USD 1.08 and USD 2.15 per person per day. Some critics questioned these measures because in many countries USD1 at PPP is not sufficient to meet daily requirements for food, clothing and shelter. Thus these figures tend to underestimate the gravity of poverty.

"The researchers now prefer a yardstick more typical of the 15 poorest countries that have credible poverty lines. By this definition, people are poor if they cannot match the standard of living of someone living on $1.25 a day in America in 2005. Such people would be recognised as poor even in Nepal, Tajikistan and hard-pressed African countries such as Uganda" (The Economist, 28 August 2008).

ii. **Relative poverty:** This is based on income differentials within a country, like half of the average
annual income. This amount is the poverty level. Relative poverty is also defined as the amount needed by a person or family to purchase the relative minimum basic necessities. [However, what is a necessity in UK is perhaps a luxury in Burundi.] In fact, the second definition is more commonly employed. In 2003, for example, the poverty level for an individual in the US (except Alaska and Hawaii) is $8980 (annual income). The poverty levels in Alaska and Hawaii are respectively $11,210 and $10,330. US also has different poverty levels for a family unit with different number of individuals. Most countries will usually adjust their poverty levels each year. However, note that even a yearly income of $8980 would allow a person to live handsomely in a developing country like India. That is why Americans with less than $8980 are in relative and NOT absolute poverty. National Poverty is the percentage of the population living below the national poverty line.

iii. Jeffrey Sachs in The End of Poverty also defined Moderate Poverty which refers to conditions of life such that the basic needs are just met. The difference between the percentage of population below the USD 2 level and the percentage of population below the USD 1 level can be used to measure Moderate Poverty. Referring to Table 1 below, Nigeria had 20.6% (90.8%-70.2%) of its population living in moderate poverty in 1997.

iv. (Total) Poverty Gap: This measures the total amount of income necessary to raise everyone who is currently below the poverty line up to that line.

v. Poverty Gap (index): This is the measure used by the World Bank and is defined as the mean (average) shortfall from the poverty line as a percentage of the poverty line. This count all the non-poor people as having zero poverty gap; no shortfall. The poverty gap in the Table 1 below which comes from WDI uses this measure. The poverty gap at USD2 per day at PPP in Mali (1994) was 60.5% per cent. This meant that in 1994, on average an amount equivalent to 60.5% of the poverty line, which is in this case USD 2, or USD 1.21 had to be given to each person below the poverty line to raise them to the USD 2 level. In another word, 72.8% of total population in Mali earned an average of USD 0.79 per day in 1994. The poverty gap can tell us home much financial aid is needed to bring everyone up to a desirable level of poverty line. If Mali had a population of 9.8 millions in 1994 then almost USD 12 millions per day (9.8 million x USD 1.21) is needed to raise everyone to the USD 2 level or about USD 4.3 billions in a year (USD 12 x 365 days).

vi. When interpreting the statistics on international poverty line, we have to keep in mind that we are dealing with percentage and not the absolute number. For instance, Mali in 2001 had 36.1% of its population living below USD 1 per day with 12.2% poverty gap at this level and 72.1% of its population living below USD 2 per day with a corresponding gap of 34.2%. It seems that Mali was very successful in poverty reduction across the board.. If Mali had a population of 9.8 millions in 1994 then 7.4 millions and 8.9 millions living below USD 1 and USD 2 per day respectively. With a population of 12 millions in 2001, the corresponding figures were 4.4 millions and 8.7 millions. Three millions people in Mali were able to grow out of the USD 1 level in the 7 years period but total number of people living below USD 2 per day did not change much in the same period of time. Moreover, these measures of poverty do not take into consideration of inflation within a country. Assuming Mali had an annual inflation rate of 3.8% using the GDP implicit deflator as a proxy, a basket of goods that cost USD 1 in 1994 would require USD 1.30 for its purchase. Thus, the three millions people who moved out of the USD 1 per day level into the next category of USD 2 per day might just be keeping up with inflation and did not actually experience any improvement in well beings.

Table 1. International Poverty Line for some poorest countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>percentage of population below USD1/day at ppp</th>
<th>percentage of poverty gap at USD1/day at PPP</th>
<th>percentage of population below USD2/day at ppp</th>
<th>percentage of poverty gap at USD2/day at PPP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mali (1994)</td>
<td>72.8</td>
<td>37.4</td>
<td>90.6</td>
<td>60.5</td>
</tr>
<tr>
<td>Nigeria (1997)</td>
<td>70.2</td>
<td>34.9</td>
<td>90.8</td>
<td>59.0</td>
</tr>
</tbody>
</table>

**Box 1. Be An Inquirer**

Update Table 1 above with more recent data. Remember to cite the year of survey and source of your data.

With the help of more recent data, identify 5 countries with the largest percentage population living below USD 1.25 per day level.

With the help of more recent data, identify 5 countries with the largest percentage population living below USD 2 per day level.

**Box 2. Some empirical support from World Economic Outlook April 2000.**

- In general the factors that are **positively correlated** (economic growth and another factor move in the same direction, i.e. the increase/improvement of this factor is matched by more growth) and robust to growth include:
  
  i. the share of investment in GDP  
  ii. school enrolment  
  iii. health indicators  
  iv. openness to trade (proxy to outward orientation)  
  v. the share of non-primary goods in total export

- Factors that are **negatively correlated** (economic growth and another factor move in the opposite direction, i.e. the increase of this factor is matched by less or even negative growth) and robust to growth include:
  
  i. weak institutional structures  
  ii. measures of political instability  
  iii. weak rule of law  
  iv. wars  
  v. market distortion.

Note, correlation does not mean causality. Take for example health indicators that are positively correlated to growth. It is possible that because of higher economic growth, people have better access to nutrition, health care and sanitation. It is also possible that healthy workers are more productive and innovative and thus generate more growth.

Nonetheless, it is well-established that accumulation of physical capital, human capital and higher technology increases per capita income.

<table>
<thead>
<tr>
<th>Growth in</th>
<th>Physical Capital, K</th>
<th>Human Capital, H</th>
<th>Productivity, A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approx. % per capita growth in developing countries</td>
<td>60-70</td>
<td>10-20</td>
<td>10-30</td>
</tr>
</tbody>
</table>
1. Previously we have studied the sources of economic growth and development, in this chapter we look at the barriers to economic growth and development. One of these barriers to both economic growth and economic development is poverty trap. A **poverty trap** is any linked combination of barriers to growth and development that forms a cycle that is self-perpetuating unless some of these links are broken. A poor household could be "trapped" in this cycle and becomes poorer by the year. Thus, some economists describe this cycle as vicious.

2. A **poverty cycle** is a schematic diagram illustrating how a combination of barriers are linked together. Diagram 1 and Diagram 2 are two examples of poverty cycles.


An impoverished household with low income spends most if not all income on consumption that is only enough to satisfy basic needs. The impoverished household has no saving and pays no tax. No saving means that the household cannot afford fertilizers for the field and unable to replace broken tools leading to poor harvest and negative growth. Increase in population and capital depreciation due to wear and tear will reduce the capital per person. All this lead to negative economic growth and lower income for the already impoverished household. The impoverished households receive no help from the government because government simply could not afford any public investment since there is small tax base in the country. The relative poor may be able to have low saving and low investment. Low investment is better than none but this may be offset by the growing population and capital depreciation and thus economic growth and income remain low.

### Diagram 2. Expanded poverty trap.

The cycle with red narrow arrows represents a vicious cycle that affects development while the one with black thick arrows affect economic growth.

3. The challenge is to design the appropriate mix of policies and conditions for poor countries to remove barriers to accumulation, efficient allocation of savings and investment in capacity.
enlargement and human capital formation that would allow growth to take off.

4. According to Jeffrey Sachs in The End of Poverty, governments in the Least Developed Countries simply could not afford to make any public investment because they receive almost no tax revenues when these nations have prevalence poverty. Take Mali, for example, 72.1% of its population were living below USD 2 per day in 2001 and these people paid zero tax. Thus, there is a need for developed countries to step in to provide aid to meet the saving gap and jump-start the economy. According to Sachs, the main objective of development for the poorest countries is to help these countries get a foothold on the ladder of development.

5. **Social and cultural factors** can be barriers to both economic growth and development however the effects are subjected to debate. In the past the work ethics of Protestantism and the discipline as well as the importance of education in Confucianism have been highlighted as factors contributing to economic growth. The lack of work ethics, discipline and a culture that emphasizes education is seen as barrier to growth and development. The prevalence of HIV/AIDS that hinders both growth and development in sub-Saharan Africa was attributed by some to a promiscuous culture. [However, this view is not supported by data cited in The End of Poverty, pg. 323]. Culture that keeps women from schools, encourages women to marry early and expects women to raise children was also unfavorable to growth and development. In Karnataka, India a study found that "74 out of 103 non-school-going girls stated that apart from the fact that they came from families with low incomes, domestic work, sibling care, and parental apathy towards their education kept them away from school. Forty one such girls (39.8%) also stated that their brothers were attending schools while they were compelled to remain at home" (Kaul 2001). Furthermore, Wood and Calandrino (2000) found that financial return for Indian female in secondary school was 64.1% per year in school while the corresponding figure for Indian boys was 26.2% in 1993-1994. Thus, culture and social attitudes that keep women away from schools basically reduces its labour force by half (i.e. a PPF that is closer to the origin than otherwise thus lower growth) and hinders human development as these uneducated females are not given the opportunity to realise their potentials and aspirations in life. More [Gender Statistics (India)](related to development at Woman and Development).

6. According to Jeffrey Sachs in The End of Poverty, "similar cultural barriers may apply to religious or ethnic minorities" and social norms may thus prevent certain groups from gaining access to schooling, health facilities or even job training (pg. 60).

7. Jeffrey Sachs in The End of Poverty warns cultural based arguments are fragile and often incorrect because (i) cultural change with economic times and circumstances and (ii) cultural interpretations are usually based on prejudice rather than measurable evidence (pg. 317).

8. At the United Nations Millennium Summit in 2000, governments agree to commit themselves to achieving a set of clear development goals by 2015 (see Box 3 below). Notice that 2 out of the 8 goals target the improvement for women. Millennium Development Goals (MDG) were expressed as quantitative targets and indicators use to track progress in this area are indiated by MDG in the Human Development Report. At the International Conference on Financing for Development at Monterrey, Mexico in March 2002, the developed nations committed themselves to providing finance for development projects. Unfortunately, as Jeffrey Sachs in The End of Poverty, these promises did not always materialize and developing countries did not receive all the pledged supports by the developed nations.

> "We will spare no effort to free our fellow men, women, and children from the abject and dehumanizing condition of extreme poverty, to which more than a billion of them are currently subjected."
> United Nations Millennium Declaration - September 2000

### Box 3. The Millennium Development Goals

1. Eradicate extreme poverty and hunger
2. Achieve universal primary education
3. Promote gender equality and empower women
4. Reduce child mortality
5. Improve maternal health
6. Combat HIV/AIDS, malaria, and other diseases
7. Ensure environmental sustainability
8. Develop a global partnership for development


Sources: