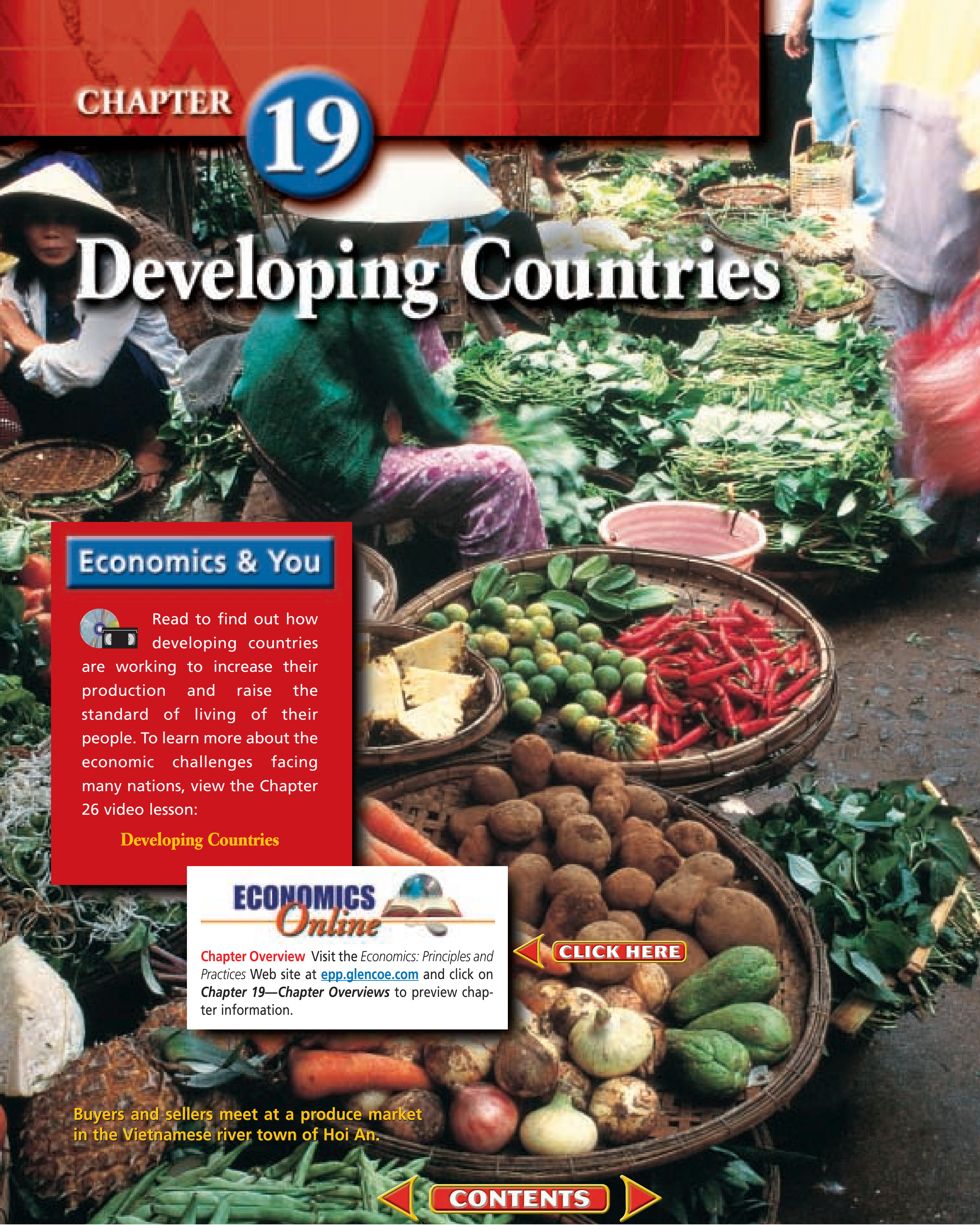


CHAPTER 19

Developing Countries

Economics & You

Read to find out how developing countries are working to increase their production and raise the standard of living of their people. To learn more about the economic challenges facing many nations, view the Chapter 26 video lesson:

Developing Countries

ECONOMICS Online

Chapter Overview Visit the *Economics: Principles and Practices* Web site at epp.glencoe.com and click on ***Chapter 19—Chapter Overviews*** to preview chapter information.

CLICK HERE

Buyers and sellers meet at a produce market in the Vietnamese river town of Hoi An.

SECTION 1

Economic Development

Study Guide

Main Idea

Developing countries face a number of obstacles that make economic growth extremely difficult.

Reading Strategy

Graphic Organizer As you read the section, complete a graphic organizer similar to the one below by providing at least two reasons why it would probably be more difficult to bring about change in a traditional economic system than in a developed country.

The difficulty of change in a traditional economy

Key Terms

developing country, crude birthrate, life expectancy, zero population growth (ZPG), external debt, default, capital flight, International Monetary Fund, World Bank

Objectives

After studying this section, you will be able to:

1. **State** the concern for the plight of the developing countries.
2. **Identify** the obstacles to economic development.
3. **Compare** per capita GNP among various countries and regions.

Applying Economic Concepts

Life Expectancy Are there any downsides to longer life expectancies? Read to find out how a longer life expectancy affects the quality of life in developing countries.

Cover Story

The Casualties Don't Stop When the War Does

Mine detecting in Cambodia

Anti-personnel (AP) land mines have become the world's largest source of war-related injuries. According to the International Committee of the Red Cross, mines kill 800 people every month and another 1,200 are maimed—a total of 2,000 victims a month—one person every 20 minutes.

Low cost and easy availability have made anti-personnel land mines the weapons of choice in the developing world. The United Nations estimates that there are currently tens of millions of anti-personnel land mines buried in more than 70 countries . . . approximately one mine for every 50 people on earth. . . .

Land mines cost as little as $3 (U.S.) to produce and up to $1,000 to remove. For every 5,000 mines cleared, one de-miner is killed and two are injured.

—*PALM Physicians Against Land Mines*, August, 1999

Most of the people in the world today live in **developing countries**—countries whose average per capita GNP is a fraction of that in more industrialized countries. Most developing countries are located in Africa, Asia, and Latin America.

In many ways, developing economies are similar to other economies of the world. The major difference is that their problems are much greater. Some problems faced by developing countries, such as the residual effects of war highlighted in the cover story, are so serious that some developing nations may never reach their potential.

Interest in Economic Development

Economists know that all nations are better off when they produce and trade the products in which they have a comparative advantage. Even so, the international community's concern for the developing countries is humanitarian as well as economic and political.

Concern for Developing Countries

Industrialized countries of the world often believe it is their moral responsibility to help those who have less than they do. Assistance to developing countries helps assure the industrial nations of a stable supply of critical raw materials. In turn, developing countries also provide markets for the products of industrial nations.

Politics are also important. Despite the dramatic failure of communism in some countries, various political ideologies wage a continuing struggle for the allegiance of developing countries.

Per Capita Income

Today more than 1.2 billion people exist on an income of less than $1 a day. According to **Figure 19.1,** the majority of these people are in Africa and Asia. The map contrasts the income of the industrialized nations and the developing nations, scaling each country to show the size of its total GNP. Recall that GNP is a measure of *income,* while GDP is a measure of output relative to other countries. Thus, the United States, which has the largest total income in the world, is the largest area on the map. Countries with smaller GNPs are scaled accordingly.

The map is also color coded to show countries with similar per capita GNPs. When viewed this way, the contrast is clearly shown between the industrialized economies of North America, Western Europe, and Japan, and the developing countries of South America, the Caribbean, Africa, and Asia. The gap between industrialized and developing countries is enormous. If anything, the gap is getting larger, rather than smaller.

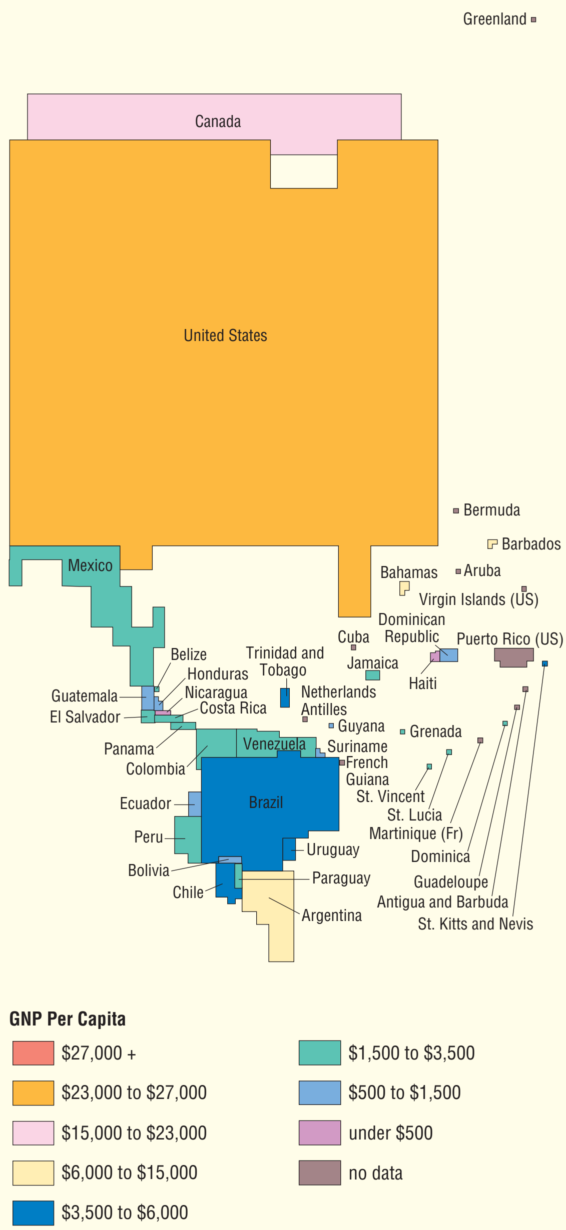
Obstacles to Development

Before examining some of the possible solutions to the plight of developing countries, we need to take a closer look at some common problems and challenges.

Population Growth

One obstacle to economic development is population growth. The populations of most developing

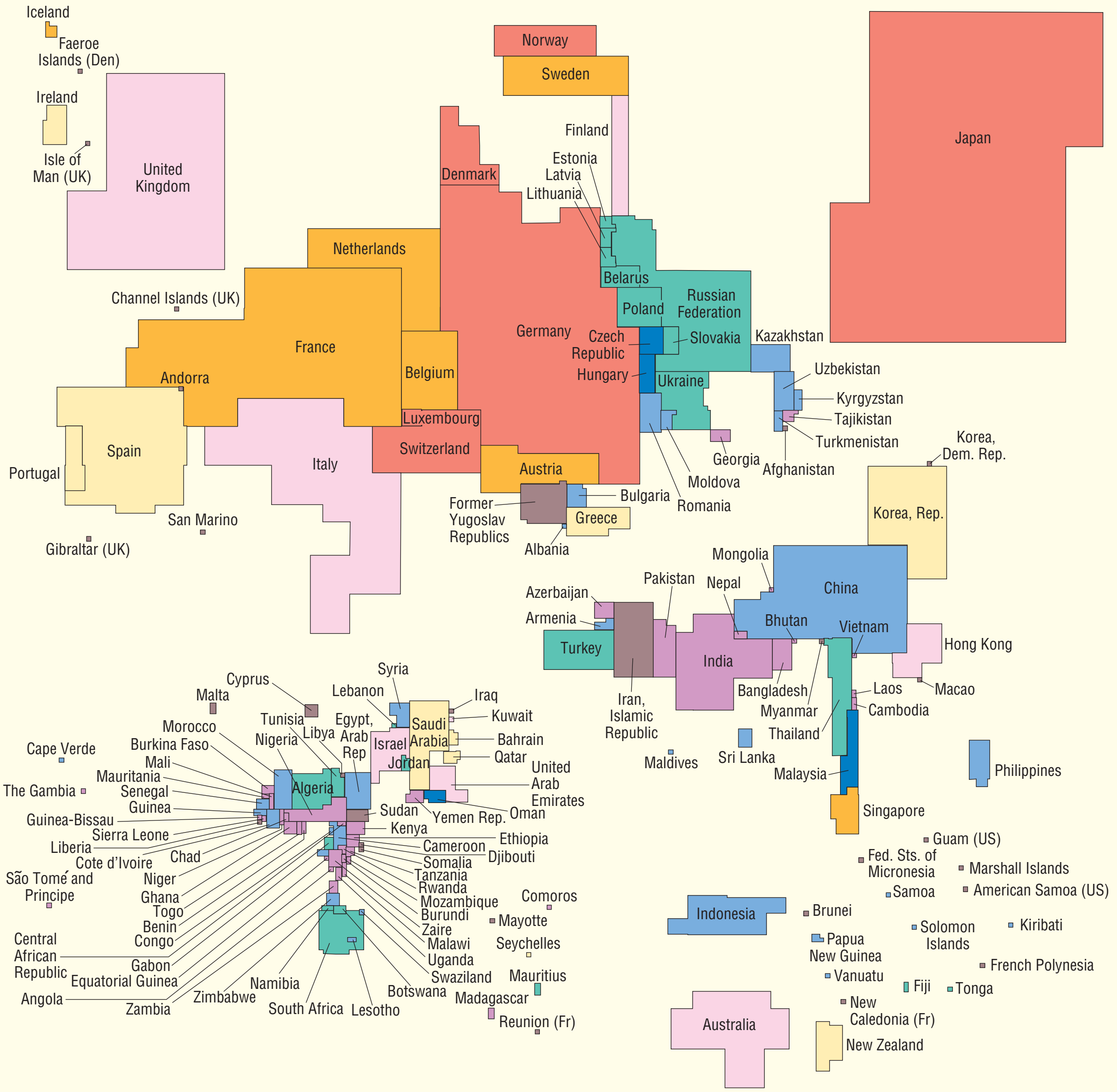
ECONOMICS AT A GLANCE



Source: *The World Bank Atlas*

Figure 19.1

Gross National Product and Gross National Product Per Capita



Reading Maps If every nation's land area were proportional to its Gross National Product, the world would look like the map in this figure. When GNP is computed on a per capita basis, we get another view of a nation's productivity. **Which nations have a per capita GNP larger than that of the United States?**

countries grow at a rate much faster than the populations of industrialized countries. One reason for this growth is the high **crude birthrate**—the number of live births per 1,000 people.

People in many developing countries are also experiencing an increasing **life expectancy**—the average remaining lifetime in years for persons who reach a certain age. Longer life expectancies, coupled with a high crude birthrate, make it difficult to increase per capita GNP.

Some countries, like China, have encouraged lower birth rates and smaller families. Some people even feel that societies should work for **zero population growth (ZPG)**—the condition in which the average number of births and deaths balance. Others feel efforts to disrupt population growth are wrong from both moral and religious perspectives.

Natural Resources and Geography

Another obstacle to economic growth is limited natural resources, which includes unproductive land and harsh climates. A shortage of natural and energy sources needed for industry also hinder growth.

In some cases, countries with limited natural resources can make up for the deficiency by engaging in international trade, as Japan has done. However, if a country is landlocked, trade is much more difficult. It is no accident that all of the major economic powers today have long had coastal cities with access to major trade routes.

Education and Technology

Still another obstacle to economic development is a lack of appropriate education and technology. Many developing countries do not have a highly literate population nor do they have the high level of technical skills needed to build an industrial society. In addition, most do not have money to train engineers and scientists.

Many developing countries cannot afford to provide free public education for school-age children. In those that can, not everyone is able to take advantage of it because children must work to help feed their families.

CYBERNOMICS SPOTLIGHT

Agricultural Development

Genetically modified cotton crops may be the means by which countries of Africa south of the Sahara become more competitive with the developed world. Some economists fear, however, that as more countries plant the genetically modified crops, the market for cotton will become saturated. Prices will drop, leaving farmers poorer than ever.

Religion

Religious beliefs may also stand in the way of economic development. While almost everyone realizes that capital investment and new technologies can help economic growth, some people may not be interested for religious reasons. In the United States, for example, many Mennonites have long rejected these advances on religious grounds.

In Asia, most Hindus and Buddhists believe that life is governed by a fate called karma; they believe that people are caught up in an eternal cycle of life, death, and rebirth. The Hindus believe that the eternal cycle can be broken, in part, by purifying the mind and body through living a simple and austere lifestyle. The Buddhists believe that the way to break the cycle is to extinguish desire and reject the temptations of the material world. Consequently, many Hindus and Buddhists—representing approximately 20 percent of the world's population—have little motivation to improve their material well-being.

The teachings of Catholicism, Protestantism, and Judaism are much more compatible with the concept of economic growth and material improvement, while the Islamic world is in between the Christians and the Hindus. We must realize, however, that some cultures may not be as interested in the Western concept of economic growth and development as we imagine.

External Debt

Another major problem facing the developing nations today is the size of their **external**

debt—money borrowed from foreign banks and governments. Some nations have borrowed so much they may never be able to repay loans.

Today a number of developing countries—Bulgaria, Cameroon, the Ivory Coast, Ethiopia, Honduras, Jordan, Madagascar, Syria, and Tanzania—all have external debts larger than their GNP. Sudan and Zambia have external debts more than twice their GDP, and Angola's external debt is *three* times larger than its GDP.

When debts get this large, countries have trouble even paying interest on the loans. As a result, some developing nations have teetered on the brink of **default,** or not repaying borrowed money. Even this strategy is dangerous, however, because a country that defaults on its loans may not be able to borrow again.

Capital Flight

Another problem for developing nations is **capital flight**—the legal or illegal export of a nation's currency and foreign exchange. Capital flight occurs because people lose faith in their government or in the future of their economy. When capital flight occurs, businesses and even the government often face a cash shortage. At a minimum, capital flight limits the funds available for domestic capital investment.

Even private citizens can contribute to capital flight. Suppose that someone in Moscow wants to turn rubles into dollars. First, the person would go to several banks and purchase traveler's checks. Next, the individual would destroy the checks and then fly to New York. Third, the checks would be declared as being lost or stolen so that they can be redeemed in the U.S. for dollars.

Corruption

Corruption at any level of government is an obstacle to economic development. Sometimes corruption takes the form of minor officials requiring modest bribes to get even the smallest things done. At other times, corruption occurs on a massive scale.

When Ferdinand Marcos was president of the Philippines, foreign investors poured billions into the country's economy. Years later, however, the majority of Filipinos still lived in poverty. Officials later charged that Marcos had stolen at least $500 million from the nation and deposited the money in personal Swiss bank accounts.

When the Soviet Union began to collapse in the late 1980s and early 1990s, the Communist party took billions of dollars out of its own accounts, government-owned enterprises, and even its own central bank and deposited the money in various Swiss, European, and American banks. At the time, the Soviet secret police used a sophisticated network of trade delegations, central bank offices, and even Soviet embassies to move the money abroad—money that could have been used to modernize the Russian economy after the fall of communism.

War and Its Aftermath

Unfortunately, many of the developing nations of the world—Angola, Afghanistan, Egypt, Ethiopia, Cambodia, Somalia, and Vietnam to name just a few—were the scenes of bloody civil wars in the late 1900s. The immediate impact of war is the devastating loss of lives and property, not to mention the damage to the country's infrastructure.

Education

Developing Nations Although enrollment in schools, and the literacy rate, are improving in developing nations, many lack basic educational tools. ***What is the status of free public education in developing countries?***

The aftermath of war can linger for decades. Poland lost virtually all of its *intelligentsia*—its scientists, engineers, and even most of its merchant class—to the gas chambers and concentration camps in World War II. The loss of this talent contributed to the slow recovery of the Polish economy after the war, and even hindered its economic development after the fall of communism.

The widespread use of chemical weapons and land mines make simple activities like farming extremely difficult in many areas. Moreover, many of the people injured by these weapons, such as children playing in fields, were not participants in the war in the first place. The weapons of war—as discussed in the cover story—often impede economic development long after the war is over.

International Agencies

The problems of the developing countries have not gone unnoticed by the more successful countries of the world. Two agencies, in particular, work directly with developing nations to solve their problems.

The **International Monetary Fund (IMF)** offers advice to all nations on monetary and fiscal policies. It also helps support the currency of some developing nations with loans so that the countries can compete in an open market and attract foreign investors.

Another important international lending and development agency is the World Bank Group, more commonly known as the **World Bank.** The World Bank is an international corporation that makes loans and provides financial assistance and advice to developing countries. The World Bank is owned by IMF member nations, but it operates as a separate organization.

Recently, the World Bank has undertaken projects to control the desert locust in East Africa. It also has funded projects to develop inland water transportation in Bangladesh, rural transportation systems in Vietnam, and even tax modernization in Kazakhstan.

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Student Web Activity Visit the *Economics: Principles and Practices* Web site at epp.glencoe.com and click on ***Chapter 19—Student Web Activities*** for an activity on the International Monetary Fund.

Section 1 Assessment

Checking for Understanding

1. **Main Idea** Describe what a developing country is and some of the economic problems it may experience.
2. **Key Terms** Define developing country, crude birthrate, life expectancy, zero population growth, external debt, default, capital flight, International Monetary Fund, World Bank.
3. **List** three reasons why there is concern for the plight of developing countries.
4. **List** eight factors that may be obstacles to economic development.
5. **Compare** the per capita GNP of Algeria with that of Argentina.

Applying Economic Concepts

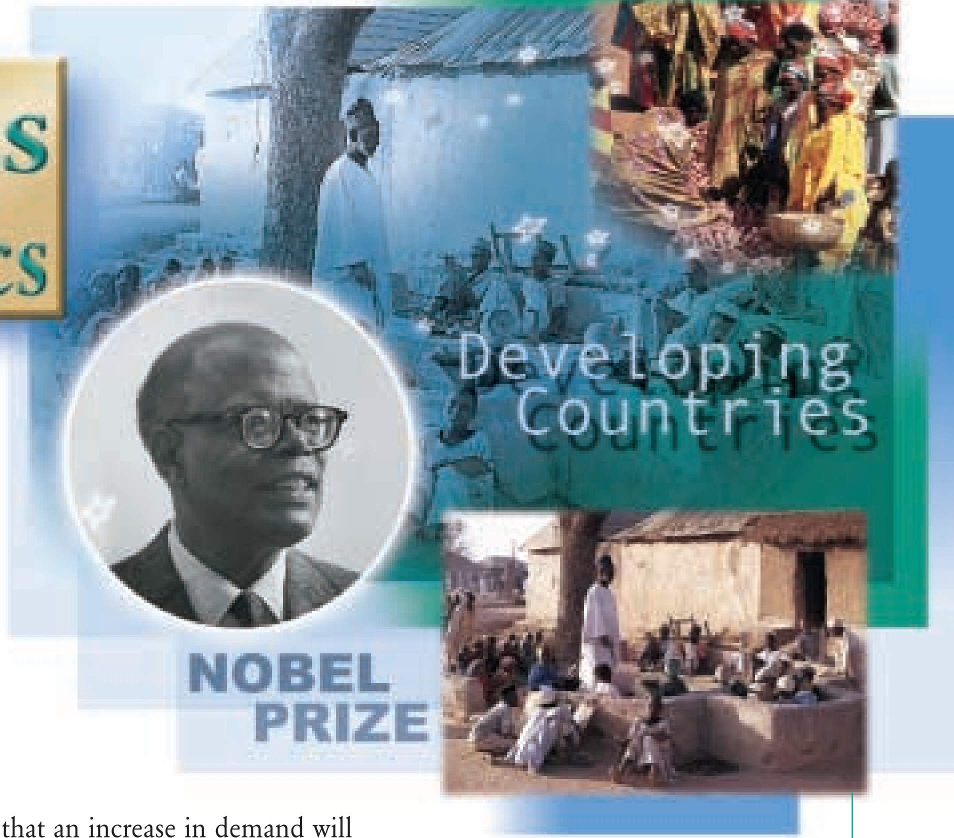
6. **Life Expectancy** Explain why an official of a developing nation would have both positive and negative views of increasing life expectancy.

Critical Thinking

7. **Identifying Alternatives** Suppose you are an official in charge of economic development in a developing country. Choose the first two obstacles to economic development that you would address. Then tell why you would tackle them first.

Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2.*

Profiles in Economics



Opening Doors:
W. Arthur Lewis
(1915–1991)

Economist Sir W. Arthur Lewis achieved many firsts. After attending school in his native St. Lucia, he earned a scholarship to attend the London School of Economics (LSE) where, in 1937, he graduated first in his class. Soon after, while working on a Ph.D. in economics, he became the first black to receive an assistant lectureship at the LSE. In 1979 he became the first black to win the Nobel Prize in economics (jointly with Theodore Schultz). Lewis's prize-winning work focused on the economic problems of developing nations.

INSIGHT INTO DEVELOPING NATIONS

In particular, Lewis challenged the prevailing view that the supply of labor in developing nations is upward sloping, so that an increase in the demand for labor results in an increase in wages. Real wages, noted Lewis, tend to stay at low levels in many developing nations regardless of the increases in demand for labor. The only solution, he reasoned, is that the supply curve for labor has to be perfectly elastic—or horizontal rather than upward sloping—so that an increase in demand will leave wages unchanged. His theory explains why countries such as Sri Lanka are still underdeveloped, although they have been developing for nearly 100 years.

Lewis did not claim to have solved the problems of the developing countries. His contributions, however, have made existing economic models and theory more applicable to realistic conditions.

"HOW I CONDUCT MYSELF"

Lewis explained how he felt about his illustrious career:

"I had never meant to be an economist. . . . What was this economics? I had never heard of it before, and nobody in St. Lucia knew what it was . . . ," he recalled. "Looking backward . . . I have lived through a period of transition. . . . I have been subject to all the usual disabilities—refusal of accommodations, denial of jobs for which I had been recommended, generalized discourtesy, and the rest of it. All the same, some doors that were supposed to be closed opened as I approached them. I have got used to being the first black to do this or that, which gets to be more difficult as the transition opens up new opportunities. Having to be a role model is a bit of a strain, but I try to remember that others are coming after me, and that whether the door will be shut in their faces as they approach will depend to some small extent on how I conduct myself."

Examining the Profile

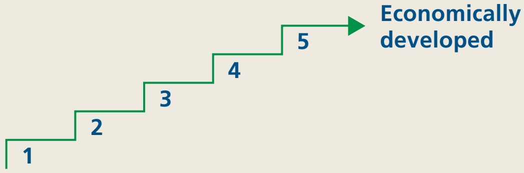
1. **Demonstrating Reasoned Judgment** Why might an increase in demand for labor not increase the wage rate in developing countries?
2. **Drawing Conclusions** What does Lewis mean by "the usual disabilities" he faced?

A Framework for Development

Study Guide

Main Idea
Economists suggest that developing nations have several ways of achieving their economic growth.

Reading Strategy
Graphic Organizer As you read the section, complete a graphic organizer similar to the one below by listing the stages of economic development. Then describe what occurs during each of the stages.



Key Terms
primitive equilibrium, takeoff

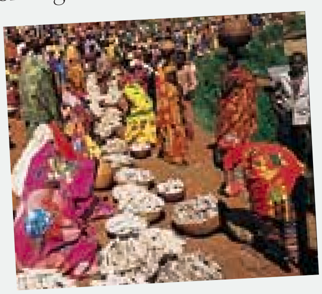
Objectives
After studying this section, you will be able to:
1. **Explain** the stages of economic development.
2. **Describe** the steps industrialized countries can take to help developing countries.
3. **Describe** the steps developing countries can follow to help themselves.

Applying Economic Concepts
Primitive Equilibrium Have you ever had a day during which nothing much was attempted and nothing much got done? Read to find out why this type of equilibrium is a stage that developing economies sometimes go through.

Cover Story

Easing the Debt Burden

COLOGNE, Germany—Leaders from the Group of Seven industrial nations agreed Friday to cut the debt burden of the world's poorest countries in what they described as a decisive push to alleviate poverty.


Market in Burundi

President Jacques Chirac of France said the relief, mainly for African countries, could total about $65 billion . . . [but] the amount could approach $90 billion if other creditors joined the initiative.

Some loans—about $15 billion worth—would be canceled outright, and mechanisms would be put in place to evaluate the countries for other forms of debt relief, based on future economic reforms.

—*The New York Times*, June 19, 1999

Because the problems of the developing nations are so great, economic development is a formidable task. Many approaches have been tried, and others, such as the one described in the cover story, have much promise.

Stages of Economic Development

Some economists have suggested that developing countries normally pass through several stages on their way to economic development. Others argue that the process is not uniform for all countries. Even so, it is helpful to think of economic development as occurring in stages, even if the boundaries between these stages are not always clear-cut.

Primitive Equilibrium

The first stage toward economic development is **primitive equilibrium.** It is "primitive" in the sense that the society has no formal economic organization. An example would be the Inuit of

Did you know?

Population Explosion Over the next 30 years, almost 98 percent of population growth is projected to take place in developing countries.

the past century, who shared the spoils of the hunt with other families in the village.

A people—or country—in primitive equilibrium often have no monetary system and may not be economically motivated. No capital investment takes place, and the society is in equilibrium because nothing changes. Rules are handed down from one generation to the next, and culture and tradition direct economic decision making.

Transition

The second stage of economic development is one of transition. It consists of a break with primitive equilibrium and a move toward economic and cultural changes. The break may be brief and sudden, or it may take years. A country does not grow economically in this transition stage, but old customs begin to crumble. People begin to question their traditions, and they try new patterns of living.

Takeoff

The third stage of development—**takeoff**—is not reached until the barriers of primitive equilibrium are overcome. A country in the takeoff stage begins to grow more rapidly than before. One reason is that customs have been put aside, and people have begun to seek new and better ways of doing things. Another reason is that the people have begun to imitate the new or different techniques that outsiders have brought into the country. Still another reason is that an industrial nation may be providing financial, educational, or military aid.

During the takeoff stage, a country starts to save and invest more of its national income. New industries grow rapidly, and profits are reinvested in them. Industry uses new production techniques, and agricultural productivity greatly improves.

Semidevelopment

The fourth stage is semidevelopment. In it, the makeup of the country's economy changes. National income grows faster than population, which leads to higher per capita income. At the same time, the core of the country's industry is built. The nation spends heavily on capital investment, and technological advances are made.

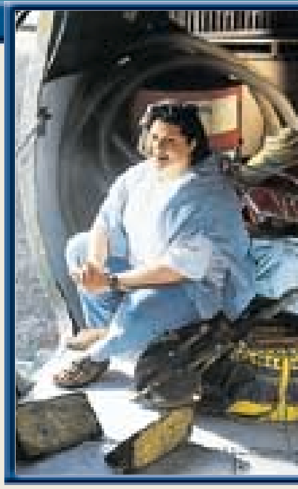
High Development

The final stage of development is high development. In this stage, efforts to obtain food, shelter, and clothing are more than successful. Most people have their basic needs and wants met. They turn their attention to services and consumer goods such as washing machines, refrigerators, and video equipment.

The nation no longer emphasizes industrial production. Instead, it increases services and provides more public goods. Mature service and

Careers

Peace Corps Volunteer



Are you willing to work for minimal pay in unfamiliar surroundings? Are you a dedicated individual who can work effectively with people?

The Work

Peace Corps volunteers take on two-year assignments overseas. They receive eight to 14 weeks of training in the history, culture, and language of the country in which they will serve. Duties include working with the people of the host country to improve food production, health care, and other basic needs. Salary is an allowance for living costs. Housing, medical care, and transportation are provided.

Qualifications

College training is not required, but assignments may be made on the basis of the volunteer's experience and skills. Volunteers must be U.S. citizens and at least 18 years old.

THE GLOBAL ECONOMY

The New Peace Corps

On March 1, 1961, President Kennedy signed an executive order establishing the Peace Corps. Since then, tens of thousands of volunteers have served in the villages, towns, and cities of more than 130 countries.

In the past, it was easy to spot Peace Corps volunteers. They wore Birkenstocks and loose-fitting, gauzy garb. They often had wide-eyed notions of saving the world. To many of them, "capitalism" was a four-letter word.

No more. Today's Peace Corps volunteers—80 percent of whom are in their 20s—still want to help the world, but they also want to help themselves. Many volunteers have business degrees and view the Peace Corps as a two-year internship, culminating with a return home to a job with a top company. What better way to gain experience than by helping a developing nation get its corporate feet on the ground?

"I'm definitely joining to improve my skills for a better job," said Beth Atkinson, 22, who recently received a bachelor's degree in business administration from Indiana Wesleyan University. Next month, she heads for Mali in West Africa to help craftsmen and entrepreneurs form businesses. "You hear a lot of talk about global business, and I thought there's no better way to go than this," she said.

—*The New York Times,* July 18, 1999

Critical Thinking

1. **Analyzing Information** According to the article, in what way is the Peace Corps changing?
2. **Understanding Cause and Effect** For what reasons are young people joining the Peace Corps?

manufacturing sectors are signs of a highly developed economy.

Priorities for Industrialized Nations

The World Bank has become a powerful force in economic development because it often requires that countries actually make market reforms as a condition for obtaining a loan. Because of its considerable experience with developing nations, the World Bank has a list of recommendations for both developing and industrialized countries.

First, trade barriers, especially nontariff barriers, need to be reduced or eliminated. The World Bank has estimated that eliminating trade barriers would generate as much as $50 billion annually in export earnings for the developing countries.

Second, industrialized countries need to implement macroeconomic policies that reduce budget deficits, lower interest rates, and stabilize inflation and foreign currency fluctuations. This would help the economic development of all types of economies. When industrialized economies grow, their increased international trade often includes, and benefits, the developing economies.

Third, the industrialized nations need to provide more external financing to the developing countries. This financing could be direct aid, or it could be indirect aid to international agencies.

Fourth, the industrial economies need to support the economic development of developing countries. Traditionally, the majority of United States foreign aid has been granted to achieve political aims. Between one-half and two-thirds of all U.S. foreign aid has been used for military supplies and training, either directly or indirectly.

Priorities for the Developing Countries

As mentioned earlier, the World Bank also has a list of recommendations for the developing countries. The developing countries face the responsibility for directing their own economic development and future.

First, governments in developing countries need to invest more in people—education, family planning, nutrition, and health care. The wealth of any nation, as Adam Smith wrote, resides in the strength and vitality of its people.

Second, improve the climate of free enterprise. Many price controls, subsidies, and other regulations that restrict the free development of markets should be removed. The World Bank suggests that competitive markets—not politicians—make the WHAT, HOW, and FOR WHOM allocation decisions.

Third, open economies to free trade. Many developing economies have quotas, tariffs, and other barriers that are used to protect domestic jobs and infant industries. At the same time, however, the trade barriers protect inefficient industries and depress a country's standard of living. Countries that open their markets to the world will benefit from comparative advantage and will ultimately develop competitive specialties of their own.

Fourth, developing countries, like the industrialized ones, need to follow policies that curb inflation, reduce borrowing, and decrease deficits. Their policies also must allow market incentives such as profits, so that the economies can begin to sustain their own growth.

Investment in People

Priorities Investment in basic health care is an important priority for developing nations. ***What is the reasoning for investing in people?***

Section 2 Assessment

Checking for Understanding

1. **Main Idea** Describe the nature of economic development. Does development happen all at once? Explain.
2. **Key Terms** Define primitive equilibrium, takeoff.
3. **List** the stages of economic development.
4. **Describe** what actions industrialized countries can take to help developing countries.
5. **Describe** recommendations that the World Bank has for developing countries.

Applying Economic Concepts

6. **Primitive Equilibrium** Imagine that a society is in primitive equilibrium—nothing is changing internally to begin economic development. Describe an event that could be a potential source of change.

Critical Thinking

7. **Making Inferences** The International Bank for Reconstruction and Development was organized near the end of World War II. For what purpose do you think it was founded?

Practice and **assess** key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2.*

BusinessWeek

DECEMBER 7, 1998

Newsclip

In 1951 the Indian Institutes of Technology (IIT) was founded. The school was established to produce an educated class to build dams, bridges, and power plants for the newly independent country. Today, IIT graduates are seen as the key to helping India prosper.

Whiz Kids

Some of the most prominent chief executives, presidents, entrepreneurs, and inventors in the world are graduates of IIT, India's elite institution of higher learning. Its impossibly high standards, compelling the mostly male student body to average fewer than five hours of sleep a night, produce [numerous] graduates who are masters at problem-solving. . . .

The rise of IITians, as they are known, is a telling example of how global capitalism works today. The best companies draw from around the world, and the result is a global class of worker: the highly educated, intensely ambitious college grad who seeks out a challenging career, even if it is thousands of miles from home. By rising to the top of Corporate America, these alumni lead all other Asians in their ability to reach the upper echelons of world-class companies. . . .

And the Indian government, to its credit, has not tried to keep these first class students at home. In many ways, the IIT grad is the hottest export India has ever produced. . . .

. . . Thousands of graduates have [immigrated] to the U.S., causing the Indian government anxiety over the brain drain of its brightest. A full 30% of the graduating class–over 500 students–headed to the U.S. for graduate degrees and better

job opportunities in 1998. In the more popular computer-science programs, nearly 80% leave for Silicon Valley. . . . While IIT does offer graduate programs, students know that an advanced degree from a U.S. institution is the entry ticket to an American or global corporation–and big bucks.

. . . The bottom line for students and grads is that India has produced a world-class university at surprisingly little cost. By nurturing the schools, the government hopes to reap huge rewards as these grads invest in India and draw it further into the circle of global trade and prosperity.

Examining the Newsclip

1. **Understanding Cause and Effect** In general, how has global capitalism affected today's college student?
2. **Making Predictions** Do you think India will benefit as IIT graduates move into the global workplace? Why or why not?

Financing Economic Development

Study Guide

Main Idea
Economists suggest that developing countries can make progress by encouraging foreign direct investment, building human capital, and encouraging regional cooperation.

Reading Strategy
Graphic Organizer As you read the section, complete a graphic organizer similar to the one below by describing what may result if resources are mobilized for the wrong reasons.

Mobilization of resources for wrong reasons → Effect

Key Terms
expropriation, soft loan, free-trade area, customs union, European Union (EU), euro, ASEAN, cartel, population density

Objectives
After studying this section, you will be able to:
1. **Describe** one internal and two external sources of funds for economic development.
2. **Explain** the role of international lending and developing agencies.
3. **Explain** how regional cooperation can assist economic growth.

Applying Economic Concepts
Growth and Development Do you think you would buy more products if you didn't have to pay tariffs? Read to find out why free-trade areas are helping developing nations today.

Cover Story

Is Dollarization on the Horizon?

NEW YORK (CNNfn)—Federal Reserve Chairman Alan Greenspan said Thursday that "dollarization" by Latin American countries might help the United States if it promoted stability in the region.

Salvadoran currency

Dollarization is when another country adopts the dollar instead of its own currency. Countries reportedly considering such a move include Mexico, Argentina and El Salvador.

Greenspan appeared with Deputy Treasury Secretary Lawrence Summers at a Senate Banking panel hearing to discuss issues that would arise if other countries wanted to adopt the dollar as their own currency.

—*CNNfn*, April 22, 1999

For a developing country to foster industries in which it has a comparative advantage, it needs capital. Funds may be needed, for example, to provide irrigation for farms or heavy equipment for mining. Capital is also needed to build roads and highways for bringing products to ports for shipment to the rest of the world.

Financial capital generally can come from different sources, but it is always hard to obtain unless the developing countries have a certain degree of financial stability. One interesting attempt to achieve financial stability, as you read in the cover story, involves the potential use of the United States dollar in place of existing domestic currencies.

Development With Internal Funds

Internal funds are an important source of capital. In many cases, they may be the only source of capital for a developing country. To generate these internal funds from savings, an economy must produce more than it consumes.

Savings in a Market Economy

If a developing country is modeled after a market economy, the incentive to save stems from the profit motive. Firms often try to borrow funds for various projects, and banks charge interest rates on savings that are set by the forces of supply and demand. If the demand for money is high, the rate will rise, and more saving will be encouraged. Saving, in turn, produces financial capital.

One economy that developed in this way was Hong Kong. Before reunification with China, government interfered very little, and people were free to pursue almost any economic activity they desired. By 1997, Hong Kong's per capita GNP was about 90 percent of that of the United States, and more than 40 times greater than China's.

STANDARD & POOR'S INFOBYTE

Brady Bonds Brady bonds provide developing nations a way to restructure their sovereign debt obligations to foreign commercial banks. In a Brady restructuring, a portion of the developing country's debt is forgiven with the balance being exchanged for various series of bonds. The maturity of these new obligations is extended, reducing the country's annual debt service requirements. To attract investors, Brady bonds are often backed by U.S. Treasury securities and offer investors attractive yields.

Savings in a Command Economy

Other developing countries, such as Cuba, the Dominican Republic, and Uganda, had command economies at one time or another. However, because the citizens were also poor, they had no ability to save on their own. Despite the poverty, their governments were still able to force savings on the economy. This was done by forcing people to work on farms, roads, or other projects the government thought were needed for economic development.

Unfortunately, history shows that although command economies can mobilize resources, they do not always use them to promote economic growth. More often, resources are mobilized for political reasons or personal gain. In addition, nearly all forced mobilizations fail to instill long-term incentives or work ethics in the people. When resources are mobilized for the wrong reasons, the cost in personal, economic, and political freedoms is higher than most people want to pay.

Development With External Funds

No matter what system of government a less developed country has, it is never easy to develop an economy with internal funds alone. Therefore, some developing countries try to obtain external funds. There are three ways they can do this.

One way a country can obtain external funds is to attract private funds from foreign investors who might be interested in the country's natural resources. This happened in the Middle East with its abundance of oil, in Chile with its abundance of copper, and in Asia with its abundance of mahogany and teakwood.

If foreign investments are to work, the arrangement must be beneficial to both the investor and the host country. Many investors are unwilling to take major risks unless they are sure that the developing country is politically stable. Developing countries that follow a policy of **expropriation**—the taking over of foreign property without some sort of payment in return—make it harder for all developing nations to attract foreign capital.

Another way to obtain external funds is through borrowing from foreign governments. The United States and other industrialized countries, including Canada and those in Western Europe, grant some aid to developing countries.

The former Soviet bloc also gave economic assistance to developing countries. More than 50 percent of its aid, however, went to allies such as Cuba, Ethiopia, Afghanistan, and Iraq. Like most other foreign aid, it was given mostly to promote political, rather than economic, ends.

A third way a country can get external financial assistance is by obtaining a loan from an international agency. The International Bank for Reconstruction and Development—part of the World Bank Group—helps developing countries with loans and guarantees of loans from private sources. In the past, many of the loans have been for projects such as dams, roads, and factories. More recently, loans have been made to developing nations in an effort to get them to change their economic policies.

Another part of the World Bank Group is the International Finance Corporation (IFC), an agency that invests in private businesses and other enterprises. The International Development Association (IDA) makes **soft loans**–loans that may never be paid back–to the neediest countries. The rates on IDA loans are interest-free and may be for periods of 35 or 40 years.

Countries can also get help from the IMF. After the Berlin Wall came down and the Soviet Union collapsed, a number of former Soviet bloc countries wanted to trade their currencies on global exchanges. The IMF provided loans to help with the conversion. Today, such currencies as the Hungarian *forint,* the Polish *zloty,* and the Czech Republic's *koruna* are listed on world markets. This is important because investors must be able to purchase the currencies of these countries to conduct international trade with them.

Regional Cooperation

Some countries have joined together to form a **free-trade area**–an agreement in which two or more countries reduce trade barriers and tariffs among themselves. The free-trade area does not try to set uniform tariffs for nonmembers. Other countries have formed a **customs union**–an agreement in which two or more countries abolish tariffs and trade restrictions among themselves and adopt uniform tariffs for nonmember countries.

The European Union

The most successful example of regional cooperation in the world today is the **European Union (EU).** The EU, formerly known as the European Community, started out as a customs union and now consists of the 15 member nations shown in **Figure 19.2** on page 536.

In January 1993, the EU became the single largest unified market–in terms of population and output–in the world, although the United States has since caught up in terms of GNP. The EU is a single market because there are no internal barriers regulating the flow of workers, financial capital, or goods and services. Citizens of the EU hold common passports, can vote in European elections, and can travel anywhere in the EU to work, shop, save, and invest.

The final stage of European integration is scheduled for 2002 when the EU introduces a single currency–the **euro**–to replace the majority of individual national currencies now issued by the member nations.

ASEAN

The economic success of the EU has encouraged other nations to try regional cooperation. In 1967 five nations–Indonesia, Malaysia, Singapore, the Philippines, and Thailand–formed the Association for Southeast Asian Nations, or ASEAN.

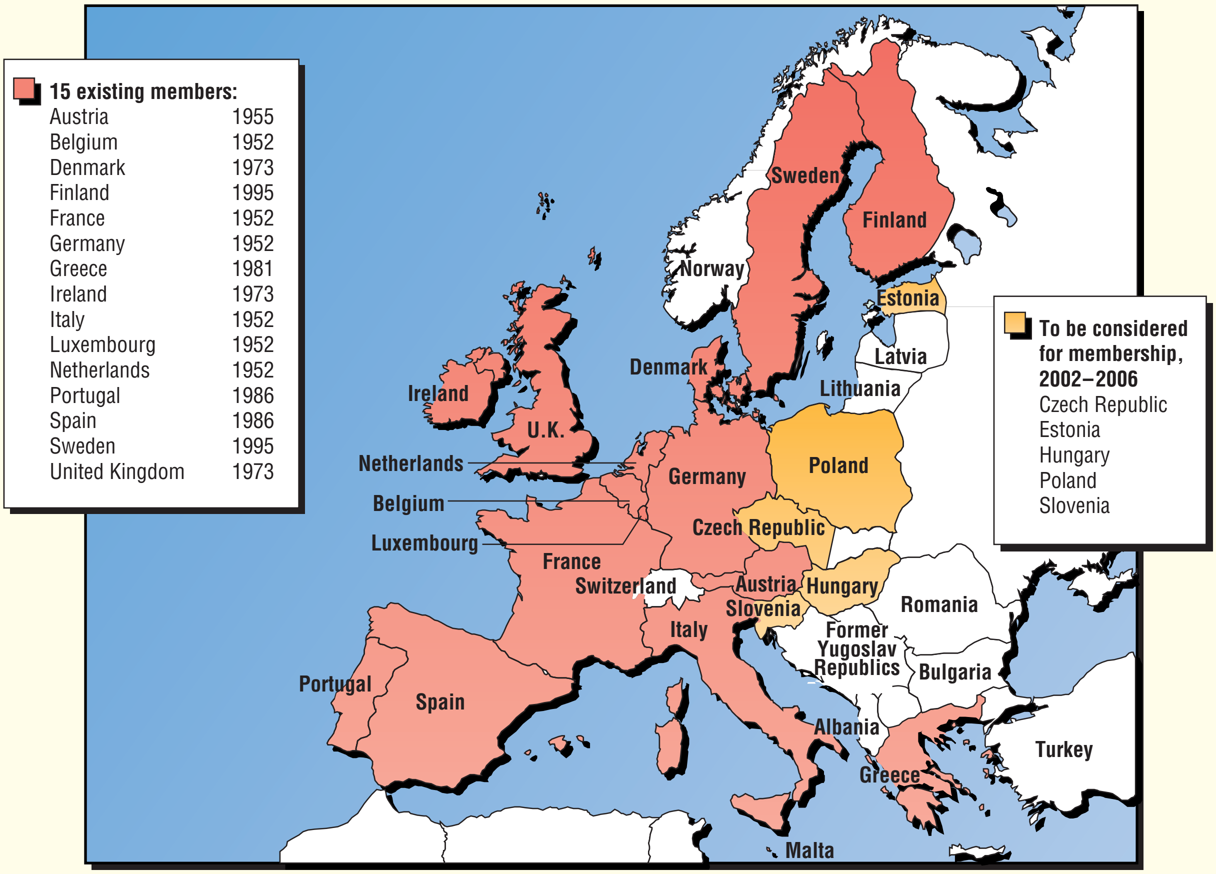
Today, **ASEAN** is a ten-nation group working to promote regional peace and stability, accelerate economic growth, and liberalize trade policies in order to become a free-trade area by 2008.

Development

External Funds This hydroelectric dam is part of the Uribante-Caparo development in the Venezuelan Andes. ***Through what agencies can developing countries borrow money to finance projects?***

ECONOMICS AT A GLANCE

Figure 19.2



Reading Maps The 15 members of the European Union currently make up the largest single market in the world, with more than 370 million people. **What are the benefits of membership in the EU?**

OPEC

A number of oil-producing nations have joined to form a **cartel**—a group of producers or sellers who agree to limit the production or sale of a product to control prices. OPEC's members were able to take advantage of a natural monopoly and push up world oil prices. Since it was organized in 1960, OPEC has successfully transferred trillions of dollars from the industrialized nations to the OPEC members as a result of higher prices paid for oil.

Even with all this financial capital, however, the growth rates of most OPEC nations were low by most standards. In Iran, revolution interrupted the development of the domestic economy. After Iraq invaded Kuwait, Iraq suffered huge losses during the Persian Gulf War. Overproduction by OPEC also pushed oil prices down.

The South Korean Success Story

One of the most successful developing nations is South Korea. In the early 1950s, South Korea was one of the poorest nations in Asia. It had the highest **population density**—number of people per square mile of land area—in the world. It also had a war-torn economy that had to be rebuilt.

The South Korean government opened its markets to world trade. In addition, the government focused only on a few industries so that its people could gain experience producing and exporting for world markets. Businesses in the South Korean economy first began to produce inexpensive toys and consumer goods for the world market. Next, they moved into textiles such as shirts, dresses, and sweaters. Then they invested in heavy industry, such as shipbuilding and steel manufacturing. Later, South Korea produced consumer and electronic goods such as radios, televisions, microwave ovens, and home computers. Most recently, the country has been making a strong bid as a leading producer of automobiles. The South Korean experience shows that a country can change a war-damaged economy to a well-developed, highly industrial one.

Economic Development

South Korea The Republic of Korea, also know as South Korea, overcame overwhelming odds to become the second largest economic power in Asia and the eleventh largest in the world. ***What plans did South Korea implement to bring about economic growth?***

Section 3 Assessment

Checking for Understanding

1. **Main Idea** What can a country do to encourage economic development?
2. **Key Terms** Define expropriation, soft loan, free-trade area, customs union, European Union (EU), euro, ASEAN, cartel, population density.
3. **Describe** one internal and two external sources of funds for economic development.
4. **Describe** the role of international lending and developing agencies.
5. **Explain** how regional cooperation aids economic growth.

Applying Economic Concepts

6. **Growth and Development** Provide an example to support the following statement: Economic growth in developing nations is often slowed by the internal political problems and external political goals of industrialized nations.

Critical Thinking

7. **Drawing Conclusions** Developing countries often need capital from foreign investors. What economic and political conditions serve to encourage this kind of investment?

Practice and **assess** key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2.*

CRITICAL THINKING Skill

Summarizing Information

Have you ever read something and just a short time later forgotten what it was all about? Summarizing information–reducing many sentences to just a few well-chosen phrases–helps you remember the main ideas and important facts contained in a longer reading selection.

Learning the Skill

To summarize information, follow these guidelines:

- Your summary should be much shorter than the reading selection.
- Your summary should contain the main ideas of the reading selection.
- Your summary should not contain your opinion. It should contain only the opinion of the person who wrote the selection.
- Your summary sentences and phrases should not be copied word for word from the selection. Write a summary in your own words to be sure that you understand the main ideas of the selection.

Memorial sculpture, Hiroshima Peace Park

Practicing the Skill

Read the selection below, then answer the questions that follow.

During the 1950s, foreign aid from industrialized countries was considered absolutely necessary for the economic growth of developing nations. European countries and Japan, just beginning to recover from the massive destruction of World War II, were unable to provide aid during that period. The United States, which had helped with Japan's and Europe's recovery, provided the largest share of aid to developing nations during that decade. When Europe and Japan became richer, the distribution burden shifted. From 1960 to 1990, the United States's percentage of total aid supplied by the Western nations to developing countries dropped from 60 percent to 17 percent.

1. What is the main idea of this paragraph?
2. What are the supporting details of the main idea?
3. Write a short summary that will help you remember what the paragraph is about.

Application Activity

Spend fifteen minutes reading and summarizing two articles on the front page of today's newspaper. Circle the articles and have a classmate ask you questions about them. How much were you able to remember after summarizing the information?

Practice and **assess** key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2.*

Chapter 19 Summary

Section 1

Economic Development (pages 521–526)

- **Developing countries** have the same problems that industrialized countries have, only their problems are much larger.
- With more than 1.2 billion people in the world existing on an income of less than $1 a day, concern for developing countries is humanitarian as well as political.

- Developing countries face numerous obstacles, including population pressures from high **crude birthrates** and increasing **life expectancies.**
- A shortage of natural resources, limited education and technology, religion, large **external debts, capital flight,** corruption, and the aftermath of war all add to the problems of developing countries.
- The **IMF** and the **World Bank** are two international agencies that help with development.

Section 2

A Framework for Development

(pages 528–531)

- It helps to think of economic development as proceeding in stages, even if this does not always describe the pattern experienced by every nation.
- The stages include **primitive equilibrium,** breaking with primitive equilibrium, **takeoff,** semidevelopment, and high development.
- The World Bank recommends that developed nations reduce trade barriers, reform macroeconomic policies, increase financial support, and support the policy reforms of the developing countries.
- The World Bank also recommends that the developing countries themselves invest in people, improve the climate for enterprise, open their economies to international trade, and revise their macroeconomic policies.

Section 3

Financing Economic Development

(pages 533–537)

- Developing countries need to encourage saving to secure a domestic source of investment funds. Command economies often try to force saving by mobilizing resources in a manner that restricts individual freedoms.
- Attempts to secure capital through **expropriation** usually backfire because foreign investors become fearful of investing.
- External funds are sometimes available from foreign governments and banks; the World Bank and the IMF also provide considerable assistance.
- Some countries have been able to help themselves through regional cooperation in the form of a **free-trade area,** or a **customs union** such as the **European Union.**

- The ten ASEAN countries are working to develop a free-trade area by 2008.
- The oil-producing nations also organized a **cartel,** called OPEC, to increase the price of oil.
- South Korea is a striking example of a developing nation having achieved success: it has developed from a poor war-torn economy to the eleventh-largest economy in the world.

ECONOMICS Online

Self-Check Quiz Visit the *Economics: Principles and Practices* Web site at epp.glencoe.com and click on ***Chapter 19—Self-Check Quizzes*** to prepare for the chapter test.

CLICK HERE

Identifying Key Terms

Write the key term that best completes the following sentences.

a. **population density**
b. **customs union**
c. **primitive equilibrium**
d. **external debt**
e. **capital flight**
f. **expropriation**
g. **free-trade area**
h. **cartel**
i. **crude birthrate**
j. **takeoff**

1. A(n) _____ is the formal arrangement to limit the production of a product.
2. A cooperative trade arrangement among nations that does not set uniform tariffs for nonmembers is called a(n) _____ .
3. A(n) _____ is a cooperative trade arrangement among nations that sets uniform tariffs for nonmembers.
4. A developing country may have a very high _____ , contributing to rapid population growth.
5. When _____ becomes too large, countries have difficulty paying the interest.
6. The least developed stage in economic development is called _____ .
7. The third stage of economic development is the _____ .
8. The problem of _____ occurs when corrupt officials take money out of the country and deposit it abroad.
9. When _____ takes place, it is harder for developing nations to attract foreign capital from industrialized countries.
10. The number of people per square mile of land is a measure of _____ .

Reviewing the Facts

Section 1 (pages 521–526)

1. **Identify** three reasons why industrialized countries are concerned about the problems of developing nations.
2. **Name** the condition in which the average number of births and deaths are approximately equal.
3. **Identify** two agencies that help developing economies.

Section 2 (pages 528–531)

4. **Describe** what happens in a developing country in the stage of breaking with primitive equilibrium.
5. **Identify** four changes that take place in the takeoff stage of economic development.
6. **List** the four World Bank recommendations for developing nations.

Section 3 (pages 533–537)

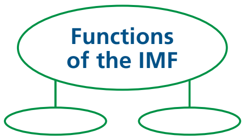
7. **Name** three sources of financial capital for development.
8. **Explain** how a developing country can attract foreign capital.
9. **List** three international agencies that provide funds for economic development.

Thinking Critically

1. **Predicting Consequences** What do you think would happen if industrialized nations and international agencies chose to withdraw support for developing nations?

Chapter 19 Assessment and Activities

2. **Summarizing Information** What are the functions of the IMF? Use a graphic organizer similar to the one below to help answer the question.



3. **Demonstrating Reasoned Judgment** Would it be effective policy for the United States to increase financial aid to developing nations, regardless of their internal political conditions or economic policies? Explain the reasoning behind your answer.
4. **Making Generalizations** Studies indicate that, in general, landlocked nations tend to have lower per capita income levels than surrounding nations that are bordered by oceans and seas. Why do you think this is the case?

Applying Economic Concepts

1. **Growth and Development** How will the economic growth and development of developing countries affect you in the future?
2. **Primitive Equilibrium** Why is it increasingly unlikely that countries in the world today will remain in the primitive equilibrium stage of economic development?
3. **Drawing Conclusions** Developing nations often need capital from foreign investors. What economic and political conditions serve to encourage this kind of investment?

Math Practice

Suppose that a small country has a per capita GNP of $20,000 and a population of 1,000,000. How large is the total GNP? If population is expected to grow by 20 percent in the next ten years, and if total GNP is only expected to be 10 percent larger, what will be the per capita GNP in 10 years?

Thinking Like an Economist

What advice would you give a developing nation that was trying to decide between a command-type economy and a market-based economy?

Technology Skill

Using E-Mail For one week, keep a journal of all the economic problems of developing nations that you hear reported in the news. List the countries in one column and their problems in a second column.

Using the information you collected, write a plan detailing how the United States could assist in alleviating some of the economic problems of a specific country. E-mail your plan to your local representative or legislator. Be sure to support your proposal with statistics, facts, quotes, and historical events.

Building Skills

Summarizing Information A summary is a list of the major points or themes of something. To summarize is to present those points or themes briefly and without details. Read the following excerpt, then summarize the main points.

A problem for many developing countries is a lack of infrastructure. Infrastructure refers to the physical developments necessary for efficient production and distribution of goods and services. Such things as roads, ports, electric generators, telephones, and sewers are considered infrastructure. Without these things, it is difficult for an economic system to function efficiently. The lack of infrastructure makes it impossible for such countries to compete successfully with more developed nations. Building an infrastructure is very expensive. Many developing nations cannot afford to invest in these improvements.

Practice and **assess** key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2.*

A Case Study:

SHOULD CHILD LABOR BE ABOLISHED?

Although it may surprise many Americans, child labor is prevalent in many parts of the world today, especially in developing countries. The estimates vary, but perhaps 200 million children under the age of 12 work regularly instead of going to school. Sometimes, the children start to work as soon as they are able; some of the youngest workers are just three years old.

Should the United States take steps to end child labor? Many people answer that question with a resounding "Yes!" They hold that child labor is immoral. The children, they say, are virtual slaves. Many are treated harshly, even cruelly—forced to work 12-hour days at mind-dulling yet dangerous tasks. These activists have put forth a variety of proposals aimed at eliminating child labor throughout the world.

Other people, however, oppose any such action. While deploring any mistreatment of children, they emphasize the contexts in which the children live. The cultures in many developing countries, they point out, support children working, while the state of the economies of these countries often requires it. Westerners, they say, may oppose child labor, but are in no position to force their beliefs onto other countries.

As you read the selections, ask yourself: Should the United States work to abolish child labor in developing countries?

PRO Child Labor Is "Reprehensible"

[There is] an unmistakable trend . . . toward convergence on global condemnation of child labor. . . .

However, . . . global child labor continues to flourish. The movement toward convergence in law seems strangely detached from everyday experience. Because it is illegal almost everywhere, child labor remains largely a hidden phenomenon, confined to the back channels and informal sectors of many economies, including advanced economies. The simple fact that child labor remains widespread would seem to belie any convergence of global sentiment around its eradication. The sheer magnitude of the problem suggests a movement in law quite divergent from plain reality. The gross dimensions of the problem provide alarming support for the conclusion that cultural relativism may be prevailing–that local exceptionalism may dominate over convergent trends.

But examination of the history of child labor in advanced economies brings the argument full circle. While it can be argued that use of child labor is particular to a nation's current stage of economic development (a relativist argument), it also appears to be true, in the main, that advanced nations, always and everywhere, have grown beyond their heavy reliance on child labor and, thus, every nation should eventually be expected to do so (a universalist argument). When the debate is shifted in this way, the relevant question becomes: is heavy reliance on child labor necessary to economic development? We have shown that it is not; that it has always been economically inefficient and injurious. . . .

Child labor is inappropriate because, first, it is (or will come to be seen as) morally reprehensible and, second, it is economically inefficient and injurious. Case closed.

–Hugh D. Hindman and Charles G. Smith,
Journal of Business Ethics

CON "Cultural Interference Is Not the Answer"

Ah, America! Thy commandeering ways!

We, the self-styled world's policeman, are seeing the error in our authoritarianism, our imposition of U.S. values on foreign cultures, our self-righteous yet mistaken belief that our way is the best way, indeed, the only way. . . . I'm talking about child labor. . . .

Even the previously unbending International Labor Organization has recognized the validity of not trying to force other cultures to adopt Western ideals. Several years ago it amended its broad-brush policy against all child labor after hearing from children in a variety of cultures at an international conference on child labor. . . .

Americans are finding out our lush economy provides luxuries to American families and children not afforded in many other countries, particularly poor ones. Most developing countries rely heavily on child labor. . . .

In developing countries, children are considered economic commodities. Parents love their children, of course, but they rely on them to help support the family and that is considered normal. As a result, the more children a poor family has, the greater a labor pool it possesses.

Former Pakistani Prime Minister Benazir Bhutto once told me that her country, one of the worst offenders, has passed laws that ban child labor. But every time she would try to enforce them, hundreds of thousands of parents would storm her residence. . . .

Every American would tell you our goal is to wipe out child labor completely: to bring developing nations on par with us economically so they no longer need to make 6-year-olds toil.

But . . . the fear is cultural, not economic, extinction. . . .

[W]e'll just have to learn to watch and worry, because, as we are just beginning to recognize, cultural interference is not the answer.

–Bonnie Erbe, *Journal of Commerce*

Analyzing the Issue

1. What are two basic objections that Hindman and Smith raise against child labor?
2. Would Hindman and Smith consider Erbe's argument "relativist" or "universalist"? Explain.
3. Do you think the United States should take steps to end child labor in developing countries? Explain your position.