

Do consequences exist for developing countries experiencing significant growth which don't improve the welfare of their citizens in conjunction?

Second Prize – 1st Year Undergraduate Category

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Abstract

Substantial attention has been given to the rapid growth of developing countries, but little consideration has been given to the state of welfare. When welfare is not improve in line with growth, substantial consequences can ensue that will serve to greatly decrease short-run as well as long-run economic growth.

What is welfare?

Before even discussing the potential consequences of not improving welfare in conjunction with economic growth, we must consider what exactly is welfare. The Oxford English Dictionary defines welfare as the “the health, happiness, and fortunes of a person or group”¹, while a more economic viewpoint would describe it as the utility gained through the consumption of goods and services. Welfare therefore, can be thought of as the standard of living, material wealth and level of prosperity of an individual or group.

Generally there is a strong causation between welfare and income based on the logic that a rise in income enables individuals to buy goods and services that will ultimately improve their standard of living. It may be the case however, that the economy is growing at a much faster rate than welfare or perhaps great disparities exist in the level of welfare amongst a population along gender, social or ethnic lines. It is also quite common in developing countries for the benefits of growth to only be shared amongst government officials and a small elite while the rest of the population remains largely impoverished. Although there is often a positive relationship between economic growth and welfare there are some factors such as the level of prosperity, perceive happiness and political & religious freedoms that are largely independent from any change in

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¹(Oxford Dictionaries, No date)

income, but are instead heavily affected by the actions of the state. Furthermore, if government fails to provide public goods and services or the inadequate enforcement of law and order, peoples' welfare will be greatly diminished no matter what their income level may be. Increased income may therefore increase welfare up until a point, but the government is the ultimate determinate of the level of wellbeing of its' citizens.

What is considered a 'developing' country?

Different governments and organisations classify developing countries differently, but they can commonly be considered to be countries with medium to low standards of adult literacy, GDP per capita, life expectancy and standards of living. A common trend among developing countries is a certain degree of restrictions on political and religious expression as well as a substantial degree of social, gender or income inequality. Developing countries usually have experienced sufficient 'take off' growth, often the result of a handful of export commodities such as oil, precious metals, agricultural products or manufactured goods, and are now in the process of further industrialising and diversifying the economy. The IMF categorises 154 countries² as developing which includes the world's Least Developed Countries (LDCs) as well as some of the Newly Industrialised Countries (NICs) like China and Mexico. Due to the economic fragility of many developing countries, the consequences of not increasing welfare in conjunction with growth are far greater than in developed countries.

Brain Drain

The new found wealth brought about by the economic growth means that thousands of families in developing countries can now afford to pay for their children to receive superior and more extensive education, resulting in a more productive and skilled work force. If however, the country is plagued by poor standards of living, inadequate infrastructure, lack of political freedom and social unrest, this new group of highly skilled professionals will immigrate to more developed countries that offer a higher quality of life in addition to higher wages. The mass emigration of skilled individuals, known as a brain drain, deprives the country of the trained professionals that it needs to run the government and provide public services. "In Zambia the public sector only retained 50 out of 600 doctors trained in the country's medical school from 1978-1999"³ which lead to severe staff shortages and a crisis in the public healthcare sector⁴. A study by the United Nations Economic Commission for Africa, found that a third of skilled professionals emigrated from African over the "two decades prior to 2005, and [Africa] has had to replace them with over

² (IMF, 2011)

³ (Aracorporation, No date)

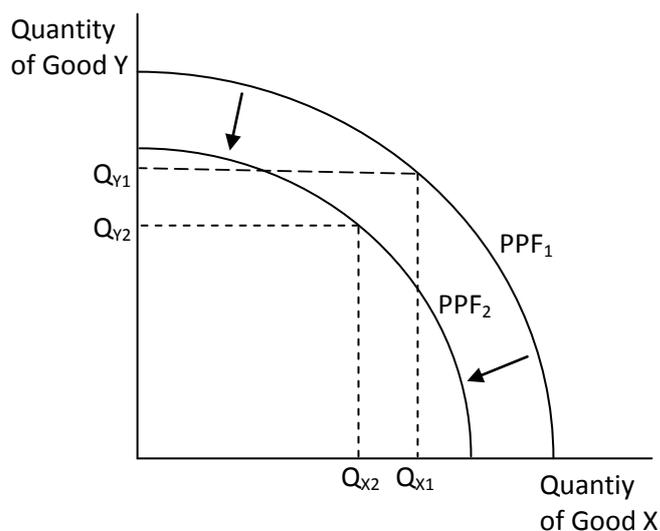
⁴ (Swinburne, 2006)

100,000 expatriate professionals at an annual cost of US\$4 billion”⁵. It is clear to see that mass emigration of skilled labour comes at an enormous cost to the economy and deprives the country of the scientists and innovative people needed to spur future growth.

Figure 1 shows the effect of a brain drain on the Production Possibility Frontier (PPF) of a developing country. The production possibility frontiers labelled PPF_1 and PPF_2 displays all the possible combinations of two goods that the economy can produce in a given time period, provided all available resources and technologies are used efficiently.

The

Figure 1: The effect of a brain drain on potential output



reduction in the quantity of human capital due to the brain drain and the consequent fall in quality of the remaining labour causes the production possibility frontier to shift inwards from PPF_1 to PPF_2 . This shift represents a contraction in the potential output of the economy given the current quantity and quality of resources, resulting in a fall in maximum PPF_1 quantity of goods X and Y that can now be produced.

There are however benefits to a brain drain, for example the remittances that are sent back by expatriates working abroad to their families still resident in their home country. In 2008, remittances by Africans to their respective home countries totalled \$45 billion⁶ serving as a huge injection of income to the continent. Furthermore, if emigrants decide to return to their home countries they bring with them newly acquired skills and knowledge that can aid the development of the economy. That said, the benefits of remittances are greatly outweighed by consequences of

⁵ (Tumfweko, No date)

⁶ (Aracorporation, No date)

a reduction in quantity and quality of labour which include the cost of replacing skilled professionals and more importantly the fall in long-term economic output.

Instability and Social unrest

Quite possibly the biggest consequence for a developing economy that fails to improve welfare is social unrest. When standards of living are low, basic freedoms are constrained or when the provision of public goods and services are largely inadequate, people display their discontent through social unrest. If these countries experience significant growth on top of this, people become even more dissatisfied because they expect their welfare to increase in conjunction of growth through higher wages or other means. Most developing countries are not fully fledged democratic states and therefore don't possess the appropriate channels for citizens to peacefully voice their concerns to the government which not surprisingly results in social unrest instead.

Despite substantial economic growth and a subsequent rise in GDP per capita, China sees 30,000 to 50,000 incidents of social unrest every year⁷ many of which are the product of environmental concerns. There are countless examples where Chinese citizens, who having seen their welfare severely impaired due to the illnesses caused by air and water pollution, have taken to the streets in protest. Much of the protest has been in demand for the closure or relocation of toxic factories, a large proportion of which are state owned, with protestors blocking the entrances to these factories in an attempt to halt production⁸. The result of this widespread protest has been the closure or relocation of many factories in China in addition to billions of dollars being paying out as compensation local inhabitants. Such unrest not only causes political instability, but is hugely disruptive and costly to the economy.

Often unrest breaks out because the benefits of economic growth are enjoyed by an elite few while the rest of the country experience no such improvement in their prosperity or quality of life. Many of the recently toppled dictators in North African had amassed huge personal fortunes while the rest of the region remained largely poor. Former president of Tunisia Zine al-Abidine Ben and his family is thought to have controlled 30% to 40%⁹ of the economy, accumulating assets worth \$13 billion while the rest of the country suffered from high unemployment, high inflation, poor standards of living and oppression despite steady economic growth over the past decade. As a result mass demonstrations and riots swept through the country which ultimately forced Ben Ali to resign in 2011¹⁰. Figure 2 shows the proportion of people that consider themselves are "thriving" in Tunisia between 2008 and 2011 which fell from 24% to 14% despite an increase in

⁷ (Bloomberg, 2013)

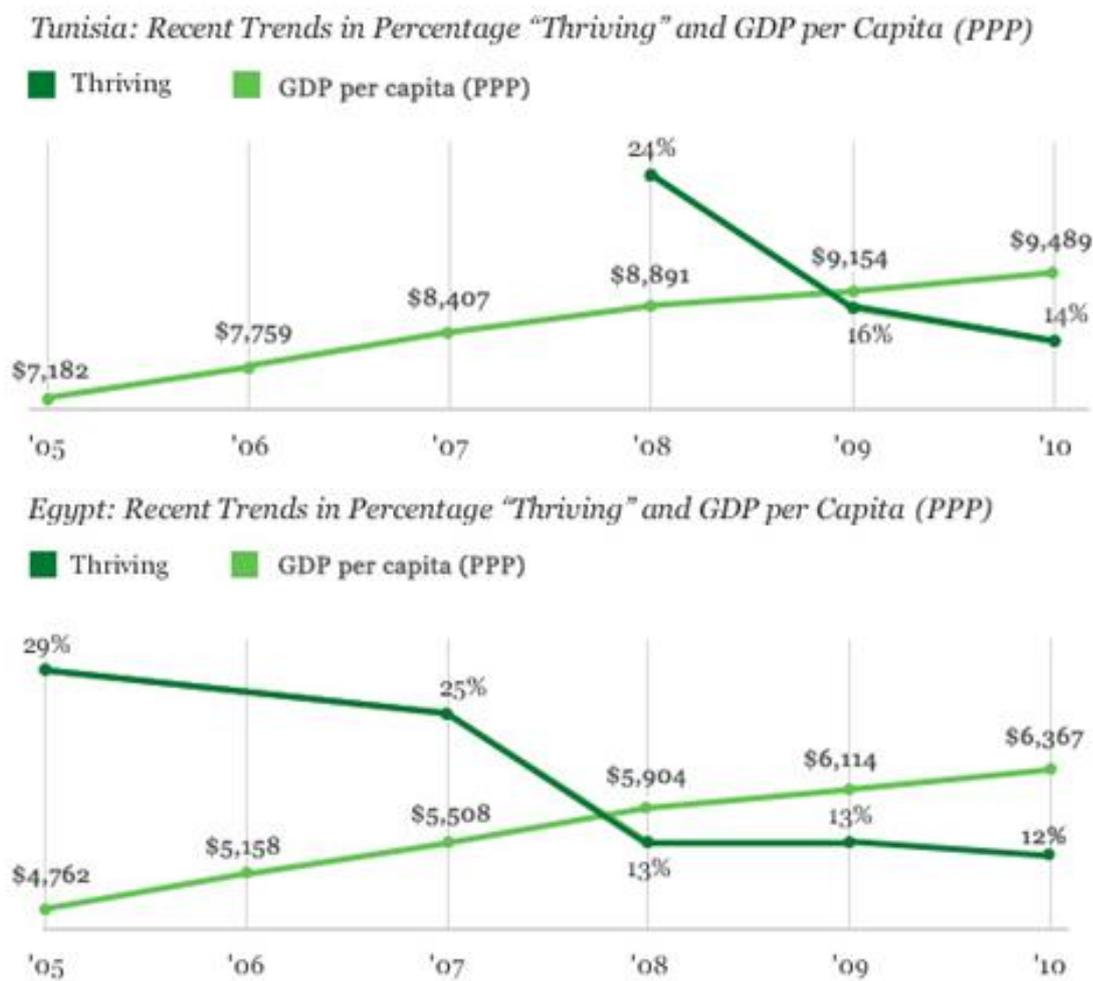
⁸ (Jacobs, 2012)

⁹ (Lewis, 2011)

¹⁰ (Chrisafis and Black, 2011)

GDP per capita at PPP¹¹. In this survey, “thriving” was taken to mean respondents sensed their wellbeing to be “strong, consistent, and progressing” with positive views about their present and future life situation. Similar trends can be seen for Egypt over the period of 2005 to 2010 suggesting that the Egyptian people were also experiencing a fall in welfare despite significant economic growth and rise in income. Ultimately decreasing levels of welfare in both countries led to mass civil unrest, huge political and economic turmoil and the eventual ousting of their respective presidents.

Figure 2: Decreasing proportion of people considered “thriving” despite GDP per capita (PPP) increases



(Clifton and Morales, 2011)

In extreme cases, discontent can be so severe that factions of the population will arm themselves in the belief that this is the only remaining option they have at gaining a better standard of living.

¹¹(Clifton and Morales, 2011)

When backed by sufficient numbers and weaponry these to and fro skirmishes can escalate into a civil war. Of course civil war is going hamper GDP due to the huge volatility and disruption it causes with one estimate by Oxford economist Paul Collier suggesting that civil war tends to reduce a country's growth rate by 2.3% a year¹². Furthermore, the UN World Invest Report found that "inflows [of FDI] to Egypt and Libya...came to a halt as result of protracted political and social instability"¹³ as foreign corporations were keen to pull out their investments in the region. It is important not to forget that civil war not only causes a contraction in the economy, but also results in the deaths of thousands if not millions of people that either die in the fighting or succumb to disease that rapidly spreads through the mass migration of refugees. Social unrest will therefore not only hinder short-term output, but also future economic growth due to the reduction in the quality and quantity of infrastructure and human capital that is incurred as a result of civil war.

Foreign Direct Investment

There are of course some positive consequences of not improving welfare in conjunction with economic growth. One such consequence is that labour will remain cheap due to poor levels of welfare that keep the general population relatively undereducated and unskilled. Multinational corporations, especially those in which labour cost make up a large proportion of the total cost of production, will seek to locate factories in these countries to take advantage of the comparatively cheaper labour and benefit from the expanding economy. This is likely to result in an enormous influx of Foreign Direct Investment (FDI) which has brought especially large levels of growth to developing countries in South and South East Asia. Inflows of FDI to Africa reach \$42.7 billion in 2011¹⁴ which is greater than the GDPs' all but 9 African countries which goes to show the size and potential FDI can have as a source of economic growth. The same year developing countries as a whole received \$684 billion in investment which was roughly 45% of world FDI inflows. Due to the globalisation of the world economy, foreign direct invest has become a huge source of economic growth that can be harnessed by developing countries if the level of welfare and most importantly the level education is suppressed, in order to keep labour comparably unskilled and therefore cheap.

¹² (Collier, 2007)

¹³ (UNCTAD, 2012)

¹⁴ (UNCTAD, 2012)

Conclusion

Although it is inherent that welfare will increase to a certain degree as a result of the economic growth, the government remain the main determinant of the standard of living and prosperity of their citizens. If welfare is not improved in line with the growth, developing countries face losing much of their skilled professionals through the process of a brain drain that will create shortages of labour as well as decreasing the potential growth of the economy. Furthermore, it is almost inevitable that if welfare is suppressed for long enough, mass social unrest ultimately ensue causing devastating effects to the country and greatly reducing current and future output. Not improving welfare may however increase the FDI inflows into the country although this is likely to be heavily outweighed by the effects of a brain drain and social unrest. To maintain current growth, it is therefore advisable for developing countries to improve welfare of their citizens to avoid these detrimental consequences.

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