

Data response question 2

(a) If an economy undergoes the process of reform shown in figures 1 and 2, identify

(i) the type of organisation which will disappear from the economy;

State marketing boards.

(ii) the additional source of revenue for the government.

Privatisation receipts.

(b) Use figures 1 and 2 to describe how the roles of the government and of the private sector will change after implementation of the reforms favoured by the World Bank.

- In terms of relative size there is a shift from a relatively large state sector to a relatively large private sector.
- Private sector is also more diverse, not only involved in agriculture as before but now also in utilities and industry.
- Government remains responsible for allocating merit goods such as infrastructure, education, whereas previously the government had also controlled funds for investment.
- Privatisation of assets previously owned by the government a deregulation of the industry creates competitive markets which encourage new firms to enter the markets, including financial, industrial and agricultural sectors.

(c) (i) What do the reforms imply for saving and consumption?

- Proportion of savings increases from 5-10% to 20-30% (from diagram).
- Rising incomes may cause the marginal propensity to save as consumers are able to plan for the future.
- Improved financial markets give people the means to save, so saving increases.
- Proportion of income consumed decreases, though actual consumption may increase due to rising incomes.

(ii) Briefly explain why economists believe that the savings ratio is important in economic development.

- Savings ratio is the proportion of income in an economy that consumers do not consume.
- The savings ratio is important because savings are required for investment to start economic growth.
- Harrod-Domar model states that the size of savings ratio is a positive determinant of the economic growth rate in an economy, alongside the productivity of investment.
- Rostow states savings were essential for an economy to achieve 'take-off' into economic growth.
- Having achieved take off economic growth creates saving and the whole process continues.

(d) Explain one economic change, which would help to create the attractive business environment identified in figure 2.

- An attractive business environment is one with low regulations and the likelihood of high projected rates of return.
- Privatisation may bring about an attractive business environment by...
 - i. No special treatment for government preferred industries. The free market allocated funds for investment effectively.
 - ii. Firms are forced to become profitable as loss-making firms are no longer funded by the government.
 - iii. Government encourages competition by the above to attract new entrants to markets where supernormal profits are being made.
- Or alternatively price liberalisation/deregulation of prices...
 - i. Abolition of preferential interest rates.
 - ii. Abolition of cheap food prices which discriminate against agriculture. Removing the state monopsony marketing boards and allowing markets to function freely encourages multi-national firms to invest as goods can be produced, sold and exported cheaply.
- Or alternatively the promotion of free trade...
 - i. Protective tariffs designed to protect infant industry would be removed.
 - ii. Promotion of exports designed to create an inflow of foreign investment.
 - iii. Applying the principle of competition to allow those working efficiently to trade and make profits and those who are loss makers will be forced to become more efficient or leave the industry.

(e) Discuss the extent to which it is appropriate for developing economies of adopt the market based economic systems of the developed countries.

- The market based economy popular in developed economies operates through consumers aiming to maximise their utility, suppliers aiming to maximise their profits and market forces acting to create efficiency within markets and the economy.
- State and explain the advantages of the market economy...
 - i. Efficient allocation of resource within markets by market forces.
 - ii. Particularly important in developing economies due to the extreme scarcity of resources, particularly funds for investment.
- State and explain the disadvantages of a planned economy...
 - i. Inefficiency with which resources were used for inefficient projects.
 - ii. Caused by imperfect knowledge of planners. Historically planners have been unable to deliver the promises of growth and development.
- State and explain the disadvantages of a market based economy...
 - i. Market failures such as externalities, public goods, merit goods, market dominance and equity.
 - ii. Equity can be thought of as a definition of development so is particularly important as equity issues may result in extreme poverty.
 - iii. Markets may not be fully developed and so are simply not available for some goods and services.
- Conclude from the above arguments that a market based approach is a good idea, but it must be one which offers sufficient scope for government intervention to correct market failure.