Supporting Synoptic Teaching of Development Economics

CPD 2018

Supporting Synoptic Teaching of Development Economics – Year 12

Turkey's Turmoil Adapted from The Economist, August 18th 2018	**Questions**
Not that long ago, many people thought that Turkey would eventually join the European Union – it was attracting significant foreign direct investment, and appeared to be highly democratic. Things have now changed significantly. Turkish domestic growth has been fuelled by borrowing from overseas, because its own banking system has not always had the funds to provide the money needed. This has resulted in a large demand for foreign currency. As the value of the Turkish Lira falls, this raises the value of the foreign-currency debt that must be repaid, threatening longer term sustainable growth in Turkey. Furthermore, the Turkish president (Mr Erdogan) believes that high interest rates cause inflation, rather than act as a policy measure that could cure it. This limits the ability of the central bank to use monetary policy effectively. This is particularly problematic as the value of the Turkish Lira falls, causing imported inflation. Indeed, annual inflation rates in Turkey are now well into double-digits. Finally, US president Donald Trump has promised to put much higher tariffs on metals exported from Turkey to the US. This is worrying given the large size of Turkey's current account deficit. Turkey has retaliated by imposing tariffs on American cars, alcohol and cosmetics.	a. Explain what is meant by foreign direct investment. b. Using a relevant exchange rate diagram, explain why increasing demand for foreign currency causes a depreciation of the domestic currency. c. Explain why a depreciating currency causes an increase in the value of foreign-currency debt that must be repaid d. Explain why high interest rates should cause inflation rates to fall. e. Why do you think it is important for a central bank to be independent of the government? f. Draw a tariff diagram to show why the US tariffs on Turkey's metal industry could cause Turkey's current account deficit to worsen.

African taxes	Questions
Adapted from The Economist, August 18th 2018 Tax collection in Africa is often highly confusing and complex. Many large firms are able to legally avoid paying taxes because of unusual exemptions, and many individuals simply work in the informal shadow economy. Estimates suggest that most African governments fail to collect around one-third of the tax that they probably should. The result is that governments do not have the money to spend on areas such as roads and schools. Some exemptions are ideal, for example, textbooks and medicines are often tax-free. Others can have other long-term benefits, such as low tax on the import of capital goods, which can lead to long-term growth. Other exemptions seem downright strange. For example, most incoming foreign aid is often tax-exempt, so the salaries of consultants or the fees paid to subcontractors who might be building factories, are not taxed. There is a boom in "Special Economic Zones" in which no taxes are paid. In Ghana, it is possible for a single factory to be declared a "free zone" which entitles it to a 10-year tax holiday and exemptions on import duties. This often benefits large overseas investors; Volkswagen (the car manufacturer) has just opened a tax-free assembly plant in Rwanda. The intention is that such tax-free zones will create jobs and additional investment. But this is not necessarily the case. Surveys suggest that most overseas investors are more interested in political stability and the local cost of raw materials, than the tax rates. Firms will be willing to establish in industrial parks if the infrastructure works and energy supplies are reliable – this requires more tax to be collected, not less. A macro impact of this is rising public sector (national) debt. Median national debt levels in sub-Saharan Africa are over 50% of GDP, up from 30% in 2012. International institutions such as the IMF and World Bank are urging African governments to close some of the loop-holes.	a. Why do you think many individuals work in the informal shadow economy in Africa? b. State and explain 3 possible impacts of a government in a sub-Saharan African country failing to collect all of the tax revenue that it should. c. Using your knowledge of market failure, explain why there should be VAT-exemptions on goods such as textbooks and medicines. d. Draw a PPF diagram for an economy such as Ghana to explain why low tax on capital goods can lead to long term growth. e. Using the data and your own knowledge, what other factors might influence a large company such as Volkswagen to set up in a country such as Rwanda? f. Use an AD/AS diagram to help explain why tax-free zones could lead to economic growth. g. Distinguish between a budget deficit and the national debt. h. Why might development economists be interested in the median level of national debt rather than the mean level of national debt?

Coffee shortage looming

Adapted from the BBC News website (19th June 2017)

Climate change is causing drought in countries, such as Ethiopia, that grow coffee beans, and so the amount of land suitable for growing coffee is shrinking rapidly. Whilst Ethiopia remains the world's largest producer of high-quality Arabica coffee beans, other countries are also set to struggle. For example, between 2017 and 2050, production in Central America will fall 48%, production in Brazil will fall by 60% and production in South East Asia will fall by 70%. Add in rising global demand for coffee (which has doubled between 1980 and 2017) and we can expect coffee prices to rise rapidly. The higher temperatures are causing a fall in the taste quality of many coffee beans.

Research by Kew Gardens in London, however, offers some hope. If the Ethiopian government is able to intervene early enough, then by altering the areas of Ethiopia dedicated to growing coffee (through replanting and forest conservation) then it may be possible to sustain supply. Although Ethiopia as a whole might benefit, the 15 million Ethiopians (16% of the population) who gain all of their income from coffee bean growing may not be able to relocate.

Brazilian coffee farmers are also struggling – average temperatures have risen 3^{o}C in a century, and rainfall has fallen 15%, in the coffee-growing areas. Many farmers have been banned from using water from reservoirs during periods of significant drought; building of new reservoirs by the Brazilian government is ongoing.

Some coffee growing countries have, however, seen increasing harvests. But this appears mostly to be due to deforestation; in other words, harvests are rising simply because countries are dedicating more land to growing coffee. In the longer term, better use should probably be made of improved technology, for example, selective plant breeding to produce arabica coffee plants more resistant to drought. The downside is the time needed to do this.

Questions

a. Estimate the PED and PES for coffee beans.

b. Using the data and your answer to question (a), explain why "we can expect coffee prices to rise rapidly"

c. Explain why producing commodities, such as coffee beans, can lead to volatile income for farmers.

d. Explain why this volatility might be a particular problem for farmers in poorer, developing countries.

e. Outline 3 reasons why the relocation of the coffee plantations in Ethiopia might be difficult to achieve, in light of Ethiopia being a developing country

f. Outline 2 advantages and 2 disadvantages of the Brazilian government's approach to solving the coffee production problem.

g. Discuss the view that governments in developing countries should not intervene to protect coffee farmers.

h. Use a PPF diagram to illustrate why focusing on improved technology in coffee farming is likely to be more helpful for growth in the long run, than deforestation.