CHAPTER 20

Economic Growth in Developing Nations

Why It's Important

How can developing countries become industrialized? Why should Americans be concerned about the economies of these countries? This chapter will explain how developing countries work to become part of the global economy.

To learn more about the economic challenges of developing nations, view the **Economics & You** *Chapter 26 video lesson:* **Developing Countries**

ECONOMICS Online

Chapter Overview Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 20—Chapter Overviews*** to preview chapter information.

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SECTION 1

Characteristics of Developing Nations

COVER STORY

THE COLUMBUS DISPATCH, JUNE 30, 1999

For coffee drinkers with a social conscience, a share of each coffee dollar now goes to fill the pockets of poor farmers instead of corporations. An importer called Equal Exchange pays coffee growers [in developing countries] a guaranteed minimum price for their beans, while cutting out middlemen to deliver the coffee from tree to table.

Before they began selling to Equal Exchange, some farmers earned as little as 20 cents a pound for their coffee. . . . Now they receive a minimum price of $1.26 a pound, plus a 15-cent premium for coffee grown without the use of chemicals.

READER'S GUIDE

Terms to Know

- developed nations
- developing nations
- subsistence agriculture
- infant mortality rate

Reading Objectives

1. About how many nations in the world are considered developed?
2. What are five economic characteristics of developing nations?
3. Why have poorly defined property rights been a problem in developing countries?

Many Americans may not realize it, but even the poorest families in the United States usually have an income far above the average income in much of the rest of the world. About one-half of the world's population lives at or close to subsistence, with just enough to survive. As you read this section, you'll learn about the characteristics of these *developing countries.*

Developed vs. Developing Nations

developed nations: *nations with relatively high standards of living and economies based more on industry than on agriculture*

developing nations: *nations with little industrial development and relatively low standards of living*

Of the more than 192 nations in the world, only about 35 are considered **developed nations.** These nations include the United States, Canada, all European countries, Japan, Australia, and New Zealand.

The remaining parts of the world's population live in **developing nations.** These are nations with less industrial development and a relatively low standard of living. Within this general definition, however, nations differ in many ways. **Figure 20.1** compares two developing nations, Madagascar and Mexico. The average income per person in Mexico is only about 30 percent that of the United States. Yet Mexico is much more developed and prosperous than almost all other developing nations.

Religion influences economic policies in some developing countries. This is not new. During the Middle Ages, the Church influenced many economic decisions throughout Europe. In colonial America, various churches influenced economics. Today some developing countries forbid lending money with interest. As a result, foreign investment in these countries is low.

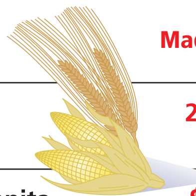
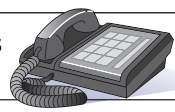
FIGURE 20.1

Two Developing Nations

Among developing nations there is a wide variance in standards of living. ***How does the per capita GDP of Madagascar compare to that of Mexico?***

Two Developing Nations

	Madagascar	Mexico
GDP from agriculture	25%	5%
Average per capita GDP	$760	$9,000
Telephone lines in use	55,000	12.3 million
Life expectancy at birth	56.14 years	72.3 years

Source: *The World Factbook*, 2003

Mexico

Madagascar

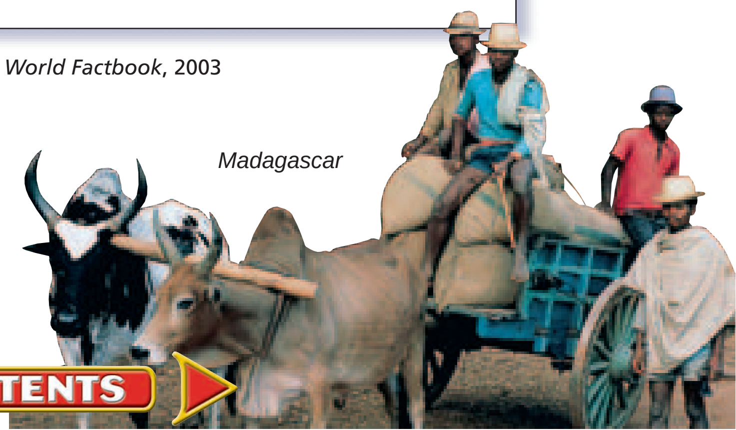


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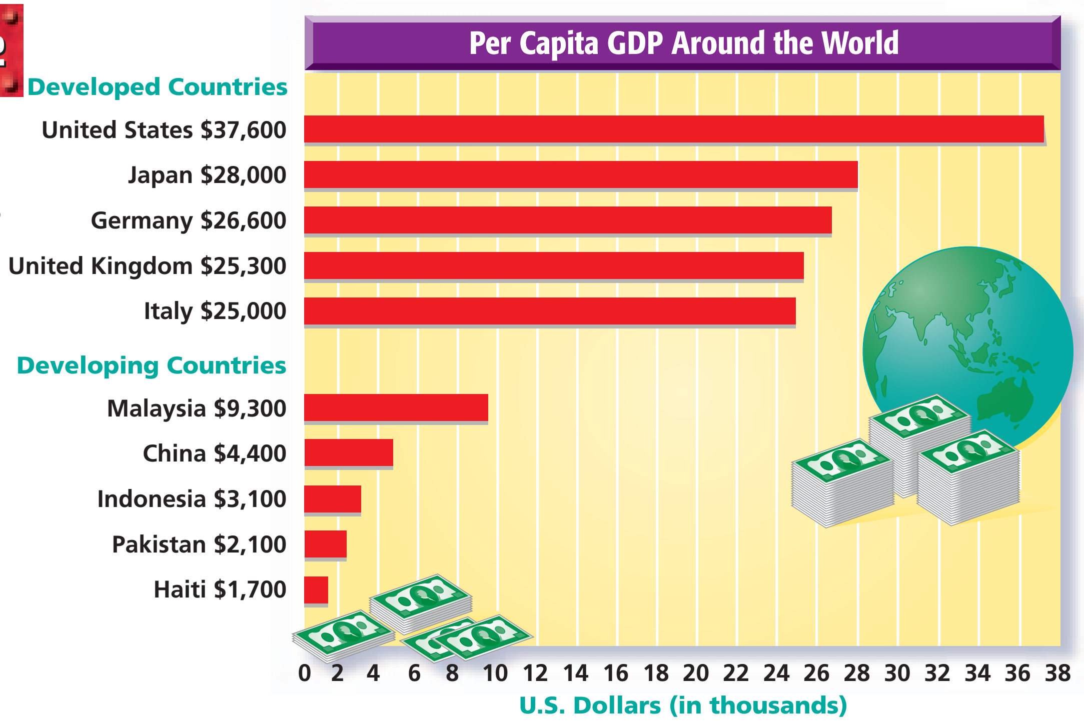
FIGURE 20.2

Measuring GDP
There is a huge difference in per capita GDP between developing and developed countries. ***What do you think this difference means in terms of everyday life?***



Source: *The World Factbook,* 2003

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Economic Characteristics

Economists often use per capita GDP as a rough measure of a nation's prosperity. Estimates of per capita GDP in the United States and other industrial nations range from $15,000 to about $35,000 per year.

Low GDP Per capita GDP in developing nations, in contrast, is considerably less, and in the world's poorest nations it is extremely low. Look at **Figure 20.2,** which shows per capita GDP for a number of developing countries. While developing nations may have many natural and human resources, they lack the equipment, financing, and knowledge necessary to put those resources to use.

An Agricultural Economy Agriculture is central to the economies of developing nations. Much of the population exists through **subsistence agriculture,** in which each family grows just enough to take care of its own needs. This means that no crops are available for export or to feed an industrial workforce.

subsistence agriculture: *growing of just enough food by a family to take care of its own needs; no crops are available for export or to feed an industrial workforce*

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FIGURE 20.3

Comparing Nations Basic needs such as food and shelter are not met in many developing nations. ***What relationship between literacy rates and infant mortality rates is apparent from the chart?***

Economic and Social Statistics for Selected Nations

Life expectancy at birth	Infant mortality: deaths per 1,000 live births	Country	Literacy (% of people who can read & write)	Population (in millions)
77	7	United States	97	290.3
81	3	Japan	99	127.2
80	5	Australia	100	19.7
79	7	Israel	95	6.1
79	6	Italy	99	58.0
72	25	China	86	1,287.0
72	24	Mexico	92	104.9
71	32	Brazil	86	182.0
63	60	India	60	1,050.0
31	199	Mozambique	48	17.5
61	66	Bangladesh	43	138.4
41	103	Ethiopia	43	66.6

Source: *The World Factbook*, 2003

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infant mortality rate: *death rate of infants who die during the first year of life*

Poor Health Conditions Poor health conditions are also common in many developing nations. Many people die from malnutrition or illness due to lack of food. Developing nations may also suffer from a shortage of modern doctors, hospitals, and medicines. The result is often a high **infant mortality rate** and a low life expectancy among adults. See **Figure 20.3.**

Low Literacy Rate A fourth characteristic of developing nations is a low adult literacy rate–the percentage of people who are able to read and write. Governments have few resources to build and maintain schools. Many children miss school to help their families farm. The lack of a large pool of educated workers makes it difficult to train the population for needed technical and engineering jobs.

Rapid Population Growth A fifth characteristic of developing nations—rapid population growth—is often the source of many other problems, such as lack of food and housing. The population in the United States grows at a rate of about 1 percent a year. The growth rate in many developing nations is three and sometimes four times this rate. With a growth rate of 3.6 percent, a nation may double its population in about 20 years.

Weak Property Rights

Perhaps the most important aspect of many developing nations is weak property rights. Economists have generally found that governments in developing countries do not support a system of strong, well-defined private property rights.

A good example is Peru. Only 20 percent of Peru's land is legally owned. On the remaining 80 percent—which has no true legal ownership—peasant farmers till the land as they have done for generations. Without specifically defined private property rights, individuals cannot exchange land. As a result, no large-scale farming has occurred in Peru, and peasant families have little incentive to improve the value of the property on which they farm.

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 1 Assessment

Understanding Key Terms

1. Define developed nations, developing nations, subsistence agriculture, infant mortality rate.

Reviewing Objectives

2. About how many nations in the world are considered developed?

3. Graphic Organizer Create a diagram like the one below to explain five economic characteristics of developing nations.

4. Why have poorly defined property rights been a problem in developing countries?

Applying Economic Concepts

5. Developing Nations Of the five characteristics of developing nations, which do you think would be most difficult to change? Why?

Critical Thinking Activity

6. Categorizing Information Using **Figure 20.3** for your data, input the information in a database. Sort the data by infant mortality, by life expectancy, and then by access to safe drinking water. Print out the new tables. Which country in your database has the highest infant mortality rate? Which country has the lowest life expectancy? Which two countries' populations have the highest access to safe drinking water?

People & Perspectives

Thomas Malthus

ECONOMIST (1766–1834)

- Professor of political economy and modern history at the college of the East India Company at Haileybury from 1805 until his death
- Served briefly as an Anglican minister in the late 1700s and early 1800s
- Major publications include *An Essay on the Principle of Population* (1798), *An Inquiry Into the Nature and Progress of Rent* (1815), and *Principles of Political Economy* (1820)

Thomas Malthus foresaw future world problems caused by a world population that was growing faster than food production. In *An Essay on the Principle of Population,* Malthus concludes that population growth will always outpace the supply of food:

> *". . . I say, that the power of population is infinitely greater than the power in the earth to produce subsistence for man.*
>
> *Population, when unchecked, increases in a geometrical ratio. Subsistence increases only in an arithmetical ratio. A slight acquaintance with numbers will show the immensity of the first power in comparison of the second.*
>
> *By that law of our nature which makes food necessary to the life of man, the effects of these two unequal powers must be kept equal."*

Malthus argues that people will always struggle to survive, and no social system can improve this condition:

> *". . . This natural inequality of the two powers of population and of production in the earth and that great law of our nature which must constantly keep their effects equal form the great difficulty that to me appears insurmountable in the way to the perfectibility of society. All other arguments are of slight and subordinate consideration in comparison of this. I see no way by which man can escape from the weight of this law which pervades all animated nature. . . . And it appears, therefore, to be decisive against the possible existence of a society, all the members of which should live in ease, happiness, and comparative leisure; and feel no anxiety about providing the means of subsistence for themselves and families."*

Checking for Understanding

1. What is Malthus's principle, stated simply?
2. According to Malthus, why can there be no happy, worry-free society?

SECTION 2

The Process of Economic Development

COVER STORY

THE COLUMBUS DISPATCH, SEPTEMBER 14, 1999

After a turbulent year in which the International Monetary Fund disbursed a record $30 billion to help beleaguered countries cope with economic troubles, the agency says the global financial crisis finally seems to be ebbing.

In its annual report, the 182-nation lending organization said that there have been encouraging signs, including a resumption of growth in some of the hardest hit nations.

READER'S GUIDE

Terms to Know

- nationalization
- foreign aid
- economic assistance
- technical assistance
- military assistance

Reading Objectives

1. Where do developing countries obtain outside sources of financing for economic development?
2. What agencies channel aid from major industrial nations to developing nations?
3. Why do nations give foreign aid?

Most nations pass through three stages of economic development. The first is the agricultural stage, when most of the population has jobs in farming. The second is the manufacturing stage, when much of the population has jobs in industry. In the third stage, many workers shift into the service sector—sales, food service, repair work, and computer and Internet services. As you read this section, you'll learn how developing nations use foreign investment and aid to move through the three stages of economic development.

FIGURE 20.4

The Agricultural Stage Many developing nations have a large labor force and the natural resources necessary for an industrial economy. They sometimes lack the financing, capital, and trained personnel to put these resources to work, however. ***What are two basic needs of nations in the agricultural stage?***

Financing Economic Development

Most developing nations are still in the agricultural stage. As **Figure 20.4** shows, three factors are evident in this stage. A basic problem for many developing nations is how to finance the equipment and training necessary to improve their standard of living.

One source of money capital is domestic savings. Many people believe that citizens of developing nations cannot save because they are barely subsisting. In fact, even very poor people do save something for their future. For example, in a traditional economy, saving may involve storing grain that can later be traded for other goods. Although this is saving, it does not provide a pool of money capital from which businesses can borrow for investment. Therefore, many developing nations must look to outside sources for investment capital. The two major outside sources of capital are investment by foreign businesses and foreign aid from developed nations.

FIGURE 20.5

Corporate Control Over Foreign Resources During the late 1970s, the Gulf and Western Corporation (later Paramount) owned 264,000 acres, or 8 percent, of the Dominican Republic's available farmland. It produced one-third of the nation's sugar and had investments in livestock, tobacco, and fruit and vegetable production as well. The corporation was accused of converting farmland used for local crops to the more profitable production of sugarcane.

Foreign Investment: Attractions and Risks

Investors are attracted to developing countries because of their low wage rates, few regulations, and abundant raw materials. Investment may include a corporation's setting up branch offices and fully owned companies, or buying into companies already established in developing nations.

Besides attractions, there are also risks to investing in developing countries. Political instability within a nation's borders leads to uncertainty. If the government changes often, or if terrorist groups threaten stability, foreign businesses may lose their investment. In some cases, the government in developing nations has taken control of private firms—a practice called **nationalization**—forcing the firm's owners out of the country.

Problems exist from the developing nation's viewpoint as well. In nations with heavy foreign investment, citizens often criticize the economic control these foreign companies have over their resources. See **Figure 20.5.** What these critics may not consider is that factors of production remain idle unless such firms organize the materials and skills of the country's inhabitants.

Economic Assistance

nationalization: *placement of industries under government ownership*

Foreign Aid

Foreign aid is a second type of financing available to nations. Sometimes it plays an important role in economic development. **Foreign aid** is the money, goods, and services given by governments and private organizations to help other nations and their citizens. Several kinds of foreign aid exist.

Economic assistance consists of loans and outright grants of money or equipment to other nations. One use of such aid is to help build transportation and communications systems. A second use for economic assistance is to purchase basic producer goods, including machinery that will increase a nation's productivity.

Technical assistance includes providing professionals such as engineers, teachers, technicians, and consultants to teach skills. Such training is designed to strengthen a nation's human resources in the same way economic assistance increases a nation's capital resources.

Military assistance involves giving either economic or technical assistance to a nation's armed forces. For example, a country may lend a developing nation the money to purchase airplanes or tanks, or it might make a gift of such goods.

foreign aid: *money, goods, and services given by governments and private organizations to help other nations and their citizens*

economic assistance: *loans and outright grants of money or equipment to other nations*

technical assistance: *aid in the form of engineers, teachers, and technicians to teach skills to individuals in other nations*

military assistance: *aid given to a nation's armed forces*

CAREERS

Peace Corps Worker

Job Description

- 2-year assignment to live overseas
- Working with the people of a host country to improve food production, health care, and other basic needs

Qualifications

- College degree helpful
- 8–14 weeks of training in the history, culture, and language of the host country

Salary: Allowance for living costs

Job Outlook: Average

—*Occupational Outlook Handbook*, 2000–01

Emergency shipments of food, clothing, and medical supplies to victims of drought, earthquakes, floods, and other disasters are also considered foreign aid. Governments, many private organizations, and several agencies of the United Nations provide such assistance. This type of foreign aid, however, is not directed toward economic development.

Who Supplies Foreign Aid?

Many of the developed nations offer some type of foreign aid to developing nations. After World War II, the United States devoted most of its foreign assistance to help rebuild Europe's war-torn economy through the Marshall Plan. Today, most American foreign aid is sent to developing nations in the Middle East and Southeast Asia. Nations in Africa receive about 11 percent, Latin America about 14 percent, and East Asia and the Pacific about 5 percent.

Comparing Aid Many other major industrial nations also give foreign aid. France and Great Britain, for example, have concentrated most of their aid programs on their former colonies in Africa and Asia. Germany and Japan both began giving aid to developing nations after their own economies had recovered from World War II.

The dollar amount of American foreign aid may sound high—$7.4 billion in 2001. When viewed as a percentage of GDP, however, that amount is just a fraction of what many other nations give in foreign aid. Norway's foreign aid, for example, is 0.9 percent of that nation's GDP. By comparison, foreign aid given by the United States is less than 0.1 percent of its GDP.

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Student Web Activity Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 20—Student Web Activities*** to keep abreast of developments in foreign aid.

Channels of Aid The United States channels much of its foreign aid to other nations through the U.S. Agency for International Development (USAID). Funds are also channeled through United Nations agencies, including the International Bank for Reconstruction and Development—usually called the World Bank. Founded in 1944, the World Bank provides loans and other services to developing nations. Two affiliates of the bank are the International Development Association (IDA), which lends money to nations that are the least able to obtain financing from other sources, and the International Finance Corporation (IFC), which encourages private investment in developing nations.

Recently, the International Monetary Fund (IMF) has become a major foreign aid agency. It has offered a variety of loans to Russia, Thailand, South Korea, Indonesia, Malaysia, Brazil, and Mexico.

These foreign aid agencies have grown increasingly alarmed as many developing nations find themselves unable to repay their foreign debts. By the late 1990s, the level of indebtedness had become extremely high, with about 40 of the most heavily indebted nations owing the IMF and World Bank more than $127 billion. In 1999 the leaders of the major industrial nations proposed a plan that would cancel some of this debt. By 2001, 23 countries had received $54 billion in debt relief under this plan.

Reasons for Giving Foreign Aid

Humanitarianism is the basis of some foreign aid. The relief of human suffering is a major goal in particular of many private aid organizations. See **Figure 20.6** on page 528. At least three other reasons are also given for providing government-sponsored foreign aid.

The first reason involves economics. It is usually in the best interests of developed nations to encourage international trade. Foreign aid expands a nation's markets for exports and provides new opportunities for private investment.

Politics is also a reason for giving foreign aid. From 1947–1991, an important objective of American foreign aid was to enhance the appeal of democracy and prevent Communists from coming to

Global Economy

Leading Suppliers of Foreign Aid

Data collected by the Organization for Economic Cooperation and Development (OECD) shows that the top five suppliers of foreign aid—in total dollars—for 2002 were as follows:

United States	$12.9 billion
Japan	$9.2 billion
Germany	$5.4 billion
France	$5.2 billion
Great Britain	$4.7 billion

When foreign aid is presented as a percentage of GDP, however, the "top five" table has a very different look:

Denmark	0.99%
Norway	0.92
Netherlands	0.83
Sweden	0.77
Luxembourg	0.71

FIGURE 20.6

Humanitarianism Many industrialized nations have decided that they have a responsibility to help end world hunger and disease.

power. The United States has also used foreign aid to build political friends that will support it in such international bodies as the United Nations.

A final reason for providing foreign aid is to help protect a nation's own security. Economic aid is often a down payment on a military alliance with a developing nation. Through alliances, the United States has gained overseas military bases and observation posts that it can use to gather information about other nations. This type of plan can backfire, however, if a friendly government loses power. In such a situation, the military equipment given to that nation would fall into the hands of the new government, one that may be hostile.

Practice and **assess** key skills with *Skillbuilder Interactive Workbook, Level 2.*

SECTION 2 Assessment

Understanding Key Terms

1. **Define** nationalization, foreign aid, economic assistance, technical assistance, military assistance.

Reviewing Objectives

2. Where do developing countries obtain outside sources of financing for economic development?
3. What agencies channel aid from major industrial nations to developing nations?
4. **Graphic Organizer** Create a diagram like the one in the next column to explain why nations give foreign aid.

Applying Economic Concepts

5. **Foreign Aid** Why do you think United States foreign aid—as a percentage of its GDP—has declined in recent years?

Critical Thinking Activity

6. **Distinguishing Fact From Opinion** Based on the information under the heading "Reasons for Giving Foreign Aid," write an opinion article titled "The Most Important Reason for Giving Foreign Aid."

SECTION 3

Obstacles to Growth in Developing Nations

COVER STORY

BUSINESS WEEK, SEPTEMBER 20, 1999

Although the sheer numbers of people living in poverty seem overwhelming—at least 3 billion subsist on less than $2 a day—[economist] Amartya Sen is optimistic that real progress can be made over the next few generations. . . .

The world's "rich" nations can help by moving ahead with debt-pardoning schemes. . . . But governments in developing countries also must cut back on military spending and corruption and spend more on health and education, especially for women.

READER'S GUIDE

Terms to Know

- bureaucracies
- capital flight

Reading Objectives

1. What are the main obstacles to economic growth in developing nations?
2. Why did Indonesia fail to sustain rapid economic growth?

The successful rebuilding of Europe's economy following World War II convinced many economists that injections of money capital into a nation could achieve rapid economic growth. As a result, billions of dollars flowed into developing nations during the 1950s and 1960s. Aid to many of these nations, however, failed to produce the same growth as Europe experienced. In this section, you'll learn why developing nations have not followed the same path of recovery as Europe did in the 1940s.

Four Obstacles to Growth

Many developing nations face a number of obstacles to growth that are not immediately solved by injections of money capital.

Economic Connection to... Geography

The World's People

There are now over 6 billion people living on the earth. More than 80 percent live in the less developed nations, and demographers (scientists who study population) say the imbalance will get worse.

Population in developing nations is growing at a rate of 1.7 percent a year—or nearly 82 million people. In contrast, the population of developed nations is increasing at a growth rate of 0.1 percent—which adds 1.5 million people annually. If growth rates remain unchanged, demographers project that the world's population will grow by some 2 billion over the next 25 years. ■

Europe's rapid recovery after World War II was a special case. In 1945 countries in Europe already had skilled labor forces, advanced organizations such as corporations and trade groups, and experienced government **bureaucracies,** or specialized offices and agencies. This is not the case in developing nations.

bureaucracies: *offices and agencies of the government that each deal with a specific area*

Attitudes and Beliefs One obstacle to economic growth resides in people's attitudes and beliefs, which are usually slow to change. In many developing nations, people live and work much as their ancestors did hundreds of years before. Innovation of any sort is often viewed with suspicion. Farmers, for example, may be reluctant to accept a new way of plowing, even though it means better soil conservation and a larger harvest.

Continued Rapid Population Growth A high population growth rate may reduce the rate of growth of a nation's standard of living. Even if a nation's economy is growing, per capita GDP will decrease if its population is growing at a faster rate.

Misuse of Resources Development in some nations has been slowed by the misuse of resources. For example, aid to the military instead could be spent on agricultural development or on training.

Corruption among government and military leaders also weakens the economies of many developing nations. Local currency may be legally exported or illegally sent from the country into leaders' private bank accounts, a practice known as **capital flight.** Even if new, honest leaders take over, they may have inherited crushing debts from previously corrupt regimes.

capital flight: *the legal or illegal export of currency or money capital from a nation by that nation's leaders*

Trade Restrictions To develop domestic industries, many developing nations have used import restrictions such as quotas and tariffs. These trade restrictions prevent consumers from purchasing cheaper foreign substitutes.

Gecko from Indonesia's rain forest

Case Study: Indonesia

When Indonesia won independence from the Netherlands in 1949, it seemed well equipped for economic growth. It was the world's sixth most populous nation. It was also rich in minerals, and had vast oil reserves as well as valuable farmland and rain forests. During his regime, President Achmed Sukarno obtained foreign aid totaling more than $2 billion from both capitalist and communist nations. Yet Indonesia's economy was a disaster.

The reasons behind this failure reveal some of the problems of trying to bring rapid growth to developing nations. One problem involved attitudes. Indonesians lacked a sense of national identity. The country had been formed from several former Dutch colonies, and its people were divided by nationality, religion, and politics. The major blame for economic failure, however, can be placed on Sukarno's economic policies. See **Figure 20.7.**

FIGURE 20.7

Indonesia's Economy Under Sukarno and Suharto

President Sukarno's Regime (1949–1965)

1. Loss of foreign aid from the United States resulted from strong opposition to capitalism.
2. Foreign aid from former Soviet Union and others was often wasted on projects for the rich such as sports stadiums and department stores. Mineral resources were not developed, and decaying roads and rail lines went without repairs.
3. Nationalization of businesses placed them under government ownership, discouraging foreign investment.
4. Heavy regulation of business, a huge government bureaucracy, and widespread corruption hurt the economy.
5. Inflation soared out of control. The nation's price index rose from 100 in 1953 to 3,000 only 10 years later. By the mid-1960s, the national debt was $2.5 billion.

General Suharto's Regime (1965–1998)

1. Control of the money supply was tightened and confidence in government increased. Initially, corruption was reduced and bureaucracy decreased.
2. Alliances with some Western nations were made.
3. Foreign aid and investment increased, and resources were focused on improving agricultural output and oil production.
4. Industry was developed. More funds could be spent on industry because fewer funds were needed to import food.
5. A system of "crony" capitalism developed—family members and close friends owned or controlled major businesses.
6. The economy declined dramatically in 1998, forcing the resignation of General Suharto as the nation's leader. He was replaced by B.J. Habibie.

Subsequent improvements in Indonesia's economy were credited to General Suharto, who assumed power in 1965. Suharto's initial economic policies, as listed in **Figure 20.7** on page 531, made Indonesia one of the fastest-growing economies among developing nations by the end of the 1970s.

Unfortunately, Indonesia found that reliance on a few products could be dangerous. In the early 1980s, the world "oil glut" cut deeply into the nation's trade income. When an economic crisis hit Southeast Asia in 1997–1998, Indonesia's economy tumbled. Riots ensued and General Suharto resigned.

Indonesia's value as a case study lies in the variety of lessons it teaches about foreign aid. It illustrates that simply pouring money capital into a developing nation will not guarantee economic growth. Indonesia also shows that growth *can* occur if government restrictions on economic activity are reduced.

Foreign aid must be used wisely in combination with domestic savings, foreign investment, and government policies that ensure economic stability. Finally, the case study points out that growth of a developing nation's economy may prove temporary if it depends on only one or two products.

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

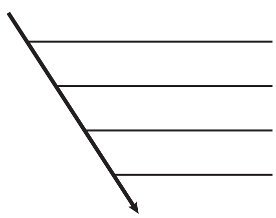
SECTION 3 Assessment

Understanding Key Terms

1. **Define** bureaucracies, capital flight.

Reviewing Objectives

2. **Graphic Organizer** Create a diagram like the one below to explain the main obstacles to economic growth in developing nations.



Obstacles to Growth

3. Why did Indonesia fail to sustain rapid economic growth?

Applying Economic Concepts

4. **Economic Policy** What economic policies exhibited by a foreign government would discourage you from investing money capital in that nation's businesses?

Critical Thinking Activity

5. **Understanding Cause and Effect** Explain why import restrictions are an obstacle to growth in a developing nation. Why do developing nations impose import restrictions such as quotas and tariffs in the first place?

BusinessWeek

Spotlight on the Economy

Indonesia—A Pariah State?

Check It Out! In this chapter you learned about Indonesia's struggle to become a developed nation. In this article, read to learn about the economic backlash it faced as a result of a 1999 government-approved massacre against civilians in Indonesia's former province of East Timor.

Indonesian military

Whatever the motives of the hardened men who run Indonesia, it is clear that the damage to this Asian giant will be immense. Nothing is certain any longer—the country's passage into democracy, its economic recovery, even who is running the government now. With relations with the International Monetary Fund already inflamed over a banking scandal, Indonesia is on the verge of being cut off from new loans that are needed to stabilize the financial system. Economists have lowered forecasts for this fiscal year, from 2% growth to negative 0.8%. Ethnic Chinese businessmen, still traumatized by deadly rioting in 1998, are moving funds offshore again. As the international backlash mounts, Indonesia is close to being branded a pariah state.

Looting in East Timor

. . . The buildup of anger does not bode well for business in Indonesia. Standard & Poor's has downgraded Indonesia's currency rating, citing political tension and the risk that international aid may be cut. On Sept. 10, a group of ethnic Chinese businessmen from Indonesia met in Singapore to compare notes on how much capital they were pulling out.

Think About It

1. **What economic actions resulted from Indonesia's massacre of East Timor citizens?**
2. **Why is it significant that capital is being removed from Indonesia?**

SECTION 4

Industrialization and the Future

READER'S GUIDE

Terms to Know

- vicious cycle of poverty

Reading Objectives

1. What are four problems of rapid industrialization in developing nations?
2. In addition to poverty, what factors influence economic development?
3. What is the relationship between the increased flow of information and international economic cooperation?

COVER STORY

HOOVER'S COMPANY PROFILES, JULY 8, 2003

Yanzhou Coal Mining Co. is helping fuel China's industrialization. The company, a leader in coal production in eastern China, produces more than 34 metric tons per year and had about 2 billion metric tons in proven and probable reserves. . . . It also owns major rail transport assets.

The high standard of living of any developed nation is usually a result of its high level of industrialization. As you read earlier in this chapter, industrialization is the second stage of economic development. As a result, many developing nations have tried to improve their standard of living by shifting their resources away from agriculture to industry. As you read this section, however, you'll learn that attempts at *rapid* industrialization can prove a wasteful use of scarce resources.

Problems of Rapid Industrialization

There are four problems of rapid industrialization: investing unwisely, not adapting to change, using inappropriate technology, and rushing through the stages of development.

Unwise Investments Some developing nations have invested in steel factories and automobile plants. These nations do not necessarily have a comparative advantage in producing steel or automobiles, however. As a result, the people in these nations are worse off. Citizens receive less economic value from their resources than they would have received from other investments. In India, for instance, steel mills produced steel 2–3 times more expensively than what it would have cost if it had been imported.

Not Adapting to Change Rapid economic change also can be harmful if a nation's population does not have time to adapt to new patterns of living and working. Suppose much of a nation is converted from subsistence farming to growing one crop for export. This may displace large numbers of people who are no longer needed for farming. Unable to find work in the countryside, many will migrate to already overcrowded cities.

Using Inappropriate Technology Another aspect of industrialization and balanced growth is the need to use technology that is appropriate, or suitable, to a culture. See **Figure 20.8.** For example, instead of buying tractors, it may be better for a nation using wooden plows to first replace them with ones made of steel. The benefits of modernization can be distributed more widely because steel plows are cheaper than tractors.

Rushing Through the Stages of Development Many economists believe industrialization is generally more beneficial if it comes about naturally. Time allows nations to adapt successfully to one stage of development before moving on to the next. Gradually, the developing nation increases its income and savings and its number of skilled and educated workers. Economic conditions reach the point where businesspeople freely decide to build factories instead of increasing farm output.

FIGURE 20.8

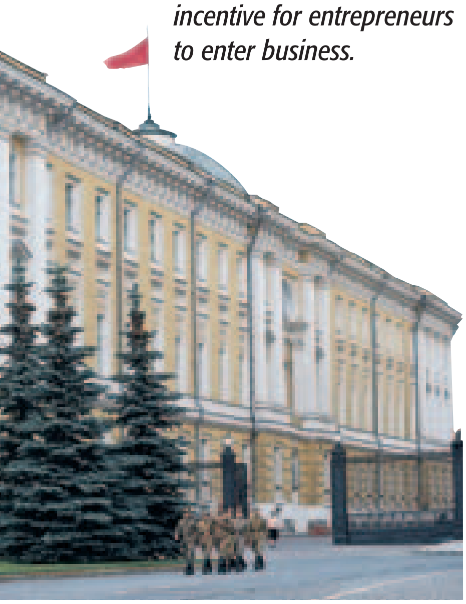
Technological Change
Many people fear change. These storekeepers in Russia still use an abacus to tally receipts as they move slowly toward capitalism.

FIGURE 20.9

Factors Influencing Economic Development Three major factors affect how nations develop economically.

A Supportive Political Structure

Typically, in countries in which government-owned business accounts for a small percentage of GDP, more economic development can be found. If, however, the political system supports and enforces any types of price controls, there will be less incentive for entrepreneurs to enter business.



B Appropriate Incentive Structure

The incentive structure in any economy determines how fast that economy will grow and develop. For example, developing countries need tax rates that are not too high and a legal system that protects private property rights.

C Trade With the Outside World

The more a country trades with the outside world, the faster it will grow. Therefore, developing nations can develop more quickly if they stop restricting trade.

Economic Development

Several major factors influence economic development, as shown in **Figure 20.9.** These include trade with the outside world, an appropriate incentive structure, and a supportive political structure. Natural resources such as trees and minerals and reduced population growth are important factors as well.

Not having one of these factors, however, does not mean that a less developed country will be trapped in underdevelopment or in the **vicious cycle of poverty.** This theory states that developing nations are poor because they cannot save and invest, but they cannot save and invest *because* they are poor.

vicious cycle of poverty: *situation in which a less-developed country with low per capita incomes cannot save and invest enough to achieve acceptable rates of economic growth and thus is trapped*

Economic development normally depends on entrepreneurs who are able to perceive opportunities and then take advantage of those opportunities. The political system must be such that risk-taking entrepreneurs are rewarded, however. That requires well-established property rights and no fear of government nationalization of business.

The more certain private property rights are, the more investment there will be. When people have property rights that are

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supported and enforced by the government, they feel confident about making investments.

Information Leads to Cooperation

Because of the media and the Internet, information about the higher standards of living of developed countries is known today even in the most remote villages of developing nations. One effect of this increased flow of information has been to convince developing nations of the benefits of working together. These nations have come to realize that, compared to large developed nations such as the United States, each developing nation has little influence over world trade. Together, however, the developing nations can and do have power in the international economic community.

A second trend in recent years has been toward more cooperation between developed and developing nations. Since 1981, leaders of both developing and developed nations have met many times. A major purpose of these meetings is to establish global negotiations aimed at a more equal distribution of the world's wealth and resources. Some suggestions to achieve this goal have included low tariffs for developing nations and an "income tax" on developed nations to pay for international assistance programs.

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 4 Assessment

Understanding Key Terms

1. **Define** vicious cycle of poverty.

Reviewing Objectives

2. **Graphic Organizer** Create a diagram like the one below to describe four problems of rapid industrialization in developing nations.

3. In addition to poverty, what factors influence economic development?
4. What is the relationship between the increased flow of information and international economic cooperation?

Applying Economic Concepts

5. **Economic Development** Assume that you are the president of a developing country. What policies would you propose to improve the nation's chances of attracting entrepreneurs?

Critical Thinking Activity

6. **Understanding Cause and Effect** How do you think the economic growth and development of developing countries will affect you in the future?

Study & Writing Skills

Taking a Test

Learning how to take a test is an important skill. Whether you are in school or looking for a job, you will be asked to take many tests during your life.

- Start studying several days before the test. In particular, review your notes and become familiar with new vocabulary terms.
- Read the test directions and the questions carefully.
- Pace yourself so that you leave enough time to answer all of the questions.
- Skip the more difficult questions, then come back to them after you've answered the other questions.
- Do not leave any answer blank. A good guess may be the correct answer.
- Some essay questions start with the words *discuss, describe,* or *explain.* This means that you must give full answers, usually written in complete sentences.

Learning the Skill

When your teacher announces that you will be tested soon, follow the guidelines for taking a test listed on the left.

Practicing the Skill

On a separate sheet of paper, answer the following questions.

1. The most important rule in taking a test is to
   a. read the directions and the questions carefully;
   b. work as fast as you can;
   c. answer all the questions.
2. Which of the following may be caused by the other three?
   a. failure on a test;
   b. not enough studying;
   c. going to bed late the night before a test;
   d. taking poor notes in class.
3. True or False? A true or false question is false if any part of it is false.

Application Activity

Learning the proper way to take a test is important, but writing the actual test questions yourself is an effective way to study for the test. Reread Section 4—Industrialization and the Future—in this chapter. Practice writing five multiple-choice questions and five true/false questions for this section.

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

CHAPTER 20 Summary

ECONOMICS Online

Chapter Overview Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 20—Chapter Overviews*** to review chapter information.

CLICK HERE

SECTION 1 Characteristics of Developing Nations

- **Developing nations** are those with less industrial development and a relatively low standard of living.
- Five characteristics of developing nations include a low GDP, an economy based on **subsistence agriculture,** poor health conditions (including a high **infant mortality rate**), a low literacy rate, and rapid population growth.
- Many developing nations have governments that do not support private property rights.

SECTION 2 The Process of Economic Development

- The three stages of economic development are the agricultural stage, the manufacturing stage, and the service sector stage.
- A basic problem for developing nations is how to finance the equipment and training necessary to improve their standard of living.
- Developing nations receive financing through foreign investment and **foreign aid.** Foreign aid can be given in the form of **economic assistance, technical assistance,** and/or **military assistance.**
- International agencies, including the World Bank and the International Monetary Fund, channel funds to developing nations.
- Developed countries provide foreign aid for humanitarian, economic, political, and military reasons.

SECTION 3 Obstacles to Growth in Developing Nations

- Four obstacles hamper economic growth in developing nations: traditional attitudes and beliefs, continued rapid population growth, a misuse of resources (including **capital flight**), and trade restrictions.
- The economic failure of Indonesia highlights some of the problems associated with rapid economic growth—lack of a national identity, massive government corruption and **bureaucracies,** reliance on a single product, and government interference in trade.

SECTION 4 Industrialization and the Future

- There are four problems of rapid industrialization: unwise investments, not enough time to adapt to new patterns of living and working, use of inappropriate technology, and inadequate time to move through the stages of development.
- Factors that spur economic growth include trade with the outside world, an appropriate incentive structure, a supportive political structure, natural resources, and reduced population growth.
- Developing countries can get out of the **vicious cycle of poverty** if their political system rewards entrepreneurs and promotes private property rights.

CHAPTER 20

Assessment and Activities

ECONOMICS Online

Self-Check Quiz Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 20—Self-Check Quizzes*** to prepare for the Chapter Test.

CLICK HERE

Identifying Key Terms

Write the letter of the definition in Column B that correctly defines each term in Column A.

Column A

1. foreign aid
2. subsistence agriculture
3. developing nations
4. technical assistance
5. developed nations
6. bureaucracies
7. nationalization

Column B

a. raising enough food sufficient for family needs only
b. nonindustrialized countries
c. money, goods, and services given by governments and private organizations to help other nations and their citizens
d. aid in the form of professional expertise from engineers, doctors, teachers, and other specialists
e. placement of railroads, businesses, and other industries under government ownership
f. nations with relatively high standards of living and economies based more on industry than on agriculture
g. offices and agencies of the government that each deal with a specific area

Recalling Facts and Ideas

Section 1

1. The per capita income in countries such as the United States, Japan, and Germany is approximately how many thousands of dollars?
2. What characteristics identify most developing nations?

Section 2

3. List two affiliates of the World Bank.
4. What is the difference between military assistance and technical assistance?
5. In what stage of development are most developing nations?
6. What are some reasons for giving foreign aid?

Section 3

7. How is rapid population growth an obstacle to economic development?
8. How do international trade restrictions hinder economic growth in developing nations?

Section 4

9. Why are property rights a factor in economic development?
10. How can a developing nation's government influence foreign investment?

Thinking Critically

1. **Making Inferences** Is an abundance of natural resources required in order for a country to have economic growth and development? Explain.
2. **Determining Cause and Effect** Create a diagram like the one below to explain the relationship between well-defined and government-enforced private property rights and the incentive structure for investment in a nation.

Applying Economic Concepts

Foreign Aid Developed countries gave much foreign aid to Russia during the 1990s. Use the information you have obtained in this chapter about the problems facing developing countries and the difficulty of using foreign aid wisely. Make a list of the obstacles that Russia faces in putting to good use the foreign aid it receives.

Cooperative Learning Project

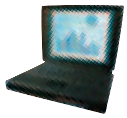
Organize into at least five groups. Each group will study one part or region of the world, such as northern Africa, central Africa, Southeast Asia, Central America, or Western Europe.

The goal of each group is to determine the percentage of the economy devoted to agriculture and the percentage devoted to industry. Each member of each group will obtain the relevant information for one or more countries in his or her chosen region. Compare the information obtained, selecting one person to prepare summary statistics for your group's region.

Reviewing Skills

Taking a Test Write 10 questions that could be used on a test for this chapter. Write 3 multiple-choice questions, 3 true/false questions, 3 matching questions, and 1 short-answer question. Include short directions for each type of question. Exchange your test with another student. After taking each other's test, analyze the questioning strategies used. Were wrong choices obvious? Which type of questions were the most difficult to answer? Why?

Technology Activity



Using E-Mail Choose a developing country to investigate. E-mail the embassy of that country in Washington, D.C. To do so, you will first need to use the Internet to locate the embassy's E-mail address. Using a search engine, type in the name of the country. Then explore the sites listed until you find the E-mail address. Finally, write an E-mail asking for information on the country's history as well as current statistics on the country's economic development. Share the responses you receive with the class.

Analyzing the Global Economy

Select a developing nation and write a research report about the economic and social conditions of that nation by collecting facts on housing, food production, transportation, medical care, and the role of the government. The most reliable sources are the International Monetary Fund Reports, United Nations reports, and government statistical bulletins.