Discuss the view that savings gaps in developing countries are the most significant constraint on economic growth. (25 marks)

A savings gap is a situation where the current level of savings is insufficient to achieve an economic objective. This is common in developing countries where there is a deficit between the current aggregate savings and the level of savings to provide funds for investment.

One reason that savings gaps in developing countries such as Cambodia are the most significant constraint on economic growth is shown in the Harrod Domar model. (Draw model). Rate of growth of GDP = Savings ratio / capital output ratio. The model suggests that the economy's rate of growth depends on the level of savings. Without investment in primary education, there is no increase in skills level of the population and so the population's income decreases with their lack of job prospect. This means that the society of the country cannot afford the provision of basic necessities and their standard of living falls. This restricts their human welfare and therefore the country's economic development and this restricts its economic growth from increasing. People will not have jobs and therefore will not have to pay taxes to the government and the cycle restricting economic growth will continue due to the savings gap.

However, the savings gap can be filled with FDI, which is not as prone to corruption than foreign aid and it means that the country will get the diffusion of skills and technology that helps the country develop in the medium term in a more self sufficient way. It also does not create the dependency that foreign aid might bring.

Another constraint on economic growth due to the savings gap is the investment in basic health care. In developing countries such as Africa, there is an outbreak of disease such as malaria. This means that without an investment in healthcare, the life expectancy of citizens who live in this country falls and therefore they have a shorter working life. A shorter working life means that they don't have enough time to accumulate income to provide for basic necessities and therefore their standard of living and human welfare falls, halting economic development leading to a fall in economic growth. Therefore, a savings gap is the most significant constraint on economic growth as economic development is a factor that if improved, results in economic growth.

A lack of investment in infrastructure due to a savings gap. This restricts the mobility of labour and therefore people who live in the periphery cannot have a job if there are no roads and it is difficult to reach their destination. Therefore, people's incomes will fall and they will not contribute to the economy's growth. Private firms also benefit from reduced costs when there is good infrastructure like good roads, stable banking systems and a legal system where they can enforce contracts. This means that firms will be hesitant to invest when there is such high risk involved, ultimately restricting the country's growth because of the initial savings gap.

Foreign aid can provide the investment necessary for a country to invest in infrastructure, therefore the savings gap is not the most significant constraint on economic growth because it is not a necessity to reach development and hence growth. However, aid is prone to corruption which would not benefit the country and there may be a dependency culture on it which the country could begin to rely on. This could cause issues a as a country becomes inefficient and does not have the incentive to work to earn money for their own economy to reach economic growth.