IGCSE Economics CIE

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5. Economic Development

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5.1 Living Standards

5.1.1 Indicators of Living Standards

Real GDP Per Capita

- **Economic development** is the sustainable increase in **living standards** for a country, typically characterised by increases in life span, education levels, & income

- There are many measures of **living standards**
  - **Single indicators** e.g. **real gross domestic product/capita,** number of doctors/1000 people; infant mortality rate; % of the population with access to clean drinking water
  - **Composite indicators** such as the **Human Development Index (HDI)**

The Distinction Between Real, Nominal & Per Capita GDP

- In economics, the use of the word **nominal** refers to the fact that the **metric** has **not been adjusted for inflation**
- **Nominal GDP** is the **actual value** of all goods/services produced in an economy in a **one-year** period
  - There has been **no adjustment** to the amount based on the **increase in general price levels** (inflation)

- **Real GDP** is the **value of all goods/services** produced in an economy in a **one-year** period - & **adjusted for inflation**
  - For example, if **nominal GDP** is $100bn and **inflation is 10%** then **real GDP** is $90bn

- **Real GDP per capita** = rGDP / the population
  - It shows the **mean wealth** of each citizen in a country
  - This makes it easier to compare **standards of living** between countries:
    - For example, Switzerland has a much higher GDP/capita than Burundi

- It is useful to know the **rGDP/capita,** however it has the following **disadvantages**
  - It is a **single indicator** so provides very limited information
  - It is an **average** so there may be **significant poverty** in many parts of a country that has a **high rGDP/capita**

Exam Tip

When an exam question uses the phrase **'at constant prices'** it is referring to **real GDP.** For example, a question may read, 'Explain what is meant by a **rise** in **GDP at constant prices'**. This requires you to define **real GDP** and then explain the rise.

The Human Development Index (HDI)

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- Developed by the United Nations, it is a combination of 3 indicators

1. **Health**, as measured by the life expectancy at birth e.g.in 2019 it was 81.2 years in the UK
2. **Education**, as measured by a combination of the **mean** years of schooling that 25 year olds have received, together with the **expected years** of schooling for a pre-school child
3. **Income**, as measured by the real GDP

- Each indicator is given **equal weighting** in the index
- The index ranks countries on a score between 0 & 1
  - The closer to 1, the higher the level of economic development & the better the **standard of living**
  - A value of < 0.550 is considered **low development** e.g. Chad 0.394
  - A value of 0.550–0.699 is considered **medium development** e.g. El Salvador 0.673
  - A value of 0.700–0.799 is considered **high development** e.g Thailand 0.777
  - A value ≥ 0.800 is considered **very high development** e.g. Norway 0.957

An Evaluation of HDI

1. It is a composite indicator & includes several important indicators of living standards
2. It includes **rGDP/capita** which is an average - so the HDI still does not take into account **inequality in the distribution of income**
3. It does not measure environmental damage or resource depletion
4. It does not take into account **cultural differences** or measure **qualitative factors** such as happiness or equal rights

Exam Tip

Both MCQ & structured questions often ask you to compare or analyse the HDI & GDP/capita of a country. On the whole, there is usually a positive relationship. Countries with a higher HDI value usually have a higher GDP/Capita. However, look for exceptions in the data presented - is the GDP/capita rising while the HDI is falling? If so, one reason may be that the inequality in the country is worsening (rich getting richer & the poor, relatively poorer).

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Reasons for Differences in Living Standards & Income Distribution

- There are many reasons that cause differences in living standards & the **income distribution** within & between countries

1. **Economic system:** a mixed economy provides the highest quality of living standards. There is much debate on **how much government planning** there should be. However, countries in Scandinavia with a more **mixed economic system** score very highly on HDI & living standards. With completely **free markets** (unchecked capitalism), wealth inequalities increase exponentially. With **planned economies**, shortages abound

2. **The Government:** the values of a government influence their economic agenda, tax system & government spending. Governments are more easily **held accountable by the citizens** in countries with a low level of corruption

3. **Corruption:** significantly undermines quality of life & the standards of living

4. **Tax system:** most countries have a **progressive tax system** for corporate & personal income tax. However, there can be many **indirect taxes** which completely change the **quality of life** for the poorest households

5. **Productivity levels:** differences in **skills** result in difference in productivity & higher levels of productivity are rewarded with **higher wages**, which leads to a better standard of living

6. **Size of the population:** more densely populated countries or cities face more challenges. A larger population can mean **higher tax revenues** but at the same time, government expenditure on services is spread across more people often resulting in **less government spending/capita**

7. **Education levels:** These directly influence productivity & wages

8. **Inflation:** Tends to impact **poorer households** more as any increase in **general price levels** represents a larger **absolute value** of their wages when compared to wealthier households

9. **Regional differences:** Many countries have historically poor areas, as well as wealthier ones. Poverty in certain regions can be much higher

10. **Personal freedoms:** religious, economic, personal, political & civil freedoms improve the quality of life within a nation

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5.2 Poverty

5.2.1 Causes of Poverty

Absolute & Relative Poverty

- **Poverty** is a situation where a person **lacks the financial resources to** sustain a basic standard of living
- Economists distinguish between **absolute & relative poverty**
- **Absolute poverty** is a situation where individuals cannot afford to acquire the **basic necessities** for a healthy & safe existence
    - These necessities include shelter, water, nutrition, clothing & healthcare
    - In 2022, the **World Bank** defined absolute poverty as anyone who was living on less than **$1.90 a day**
    - Absolute poverty is more prevalent in **developing countries** than developed ones
- **Relative poverty** is a situation where household income is a certain percentage less than the **median household income** in the economy
    - Poverty in a household is considered relative to **income levels** in other households
    - E.g. The UK defines relative poverty as households that are living with less than 60% of the **median household income**
        - In May 2022, the median UK monthly household income was £2072/month
        - This meant that the **relative poverty line** was any household earning less than £1243,20/month
- **Relative poverty** is the main form of poverty that occurs in **developed** countries

Causes of Poverty

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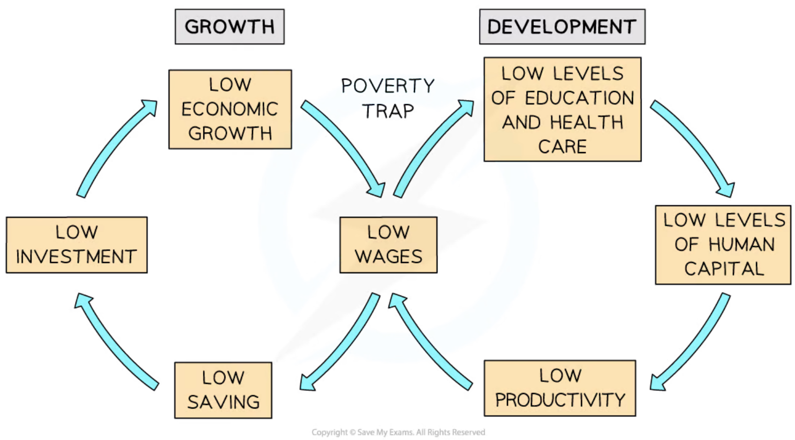
- There are many **causes of poverty.** However, poor countries have several **common characteristics** which can be summarised in a **poverty cycle diagram**



Poverty is caused by a lack of both economic growth & human development

- **Low wages** represent the intersection of economic growth & human development & are the major cause of poverty
    - Low wages are usually the result of **unemployment**, **informal employment**, a lack of skills, or a **primary sector** based economy

- **Education & healthcare** cost money & with lower wage levels these are not accessible, resulting in poor **human capital**
    - People find it harder to stay well or to **recover from illness** resulting in **lower productivity** & **shorter life expectancy**

- **Low productivity** results in low wages & the cycle continues

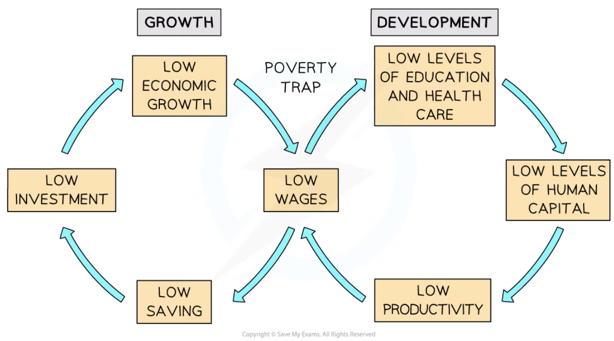
- **Populations** with a large number of **dependents** (old people & children) for each working household tend to experience **higher levels of poverty**

5.2.2 Policies to Alleviate Poverty

Policies Aimed At Alleviating Poverty

- The **poverty cycle diagram** (below) was introduced in the previous subtopic & helps to explain the **causes of poverty**
- **Any policy** that helps to **break the poverty cycle** at any point will help to improve the **standards of living** within a country

- **Policies** used to alleviate poverty include **promoting economic growth**, improving education, providing more generous state benefits, progressive taxation, & the establishment/increase of a **national minimum wage**



Policies which help to improve any factor in the diagram will help to alleviate poverty

How Different Policies Alleviate Poverty

Policy	Explanation	Impact on Poverty Cycle
Promoting economic growth	• Removing **protectionism** or engaging in expansionary demand & supply-side policies will **promote growth** • Data shows that **economic growth** has a very positive impact on **economic development** • In most cases **growth precedes development** • Often in less developed countries, economic growth is linked to **one industry** & generates many **negative externalities of production** possibly resulting in decreased living standards	Higher growth → **higher wages** → better education/healthcare → better human capital → better productivity → higher income

Improving education	• Investing in this **supply-side policy** increases the potential output of the country (shifts the **production possibility frontier** outwards)	Higher education/skill levels → **higher human capital** → increased productivity → higher output → higher income
More generous state benefits	• State benefits are usually given to the **poorest & most vulnerable** people in society • State benefits include **unemployment & disability payments**, pension payments, heating discounts, public transport subsidies etc.	More benefits → **higher wages** → better education/healthcare → better human capital → better productivity → higher wages
Progressive taxation	• A **progressive tax system** redistributes from those with higher income to those with lower income & reduces **income inequality** • Redistribution often starts with the provision of **free education & healthcare** • Sometimes the benefits of a good **progressive tax** system are eradicated by the penalties imposed through **multiple regressive (indirect) taxes**	Higher redistribution → **better education/healthcare** → better human capital → better productivity → higher income
Establishment/increase of national minimum wage	• **Minimum wages** are set above the free market rate • Firms are not allowed to pay anyone less than the **legal rate**	**Higher wages** → better education/healthcare → better human capital → better productivity → higher wages

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5.3 Population

5.3.1 Population Growth

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Factors that Affect Population Growth

- **Population** refers to all of the inhabitants of a particular country
- The **population growth rate** is the size of the change in the population of a country, expressed as a percentage

- **The following factors affect population growth**
  - The annual **birth rate**
  - The annual **death rate**
  - The **net migration**
    - A higher birth rate & lower death rate would both **increase the population**
    - More **immigration** than **emigration** would increase the growth rate

- All countries have **different rates** of population growth
  - Population growth rates are currently highest in **less economically developed countries** such as Niger, Mali and Zambia
  - Population growth rates are lowest in **more economically developed countries**
  - In some **MEDCs** such as Italy and Japan, the population is decreasing as the number of deaths is higher than the number of births

Exam Tip

MCQ will often check your understanding of the differences between these terms. Remember immigration & emigration are not the same. Immigration is the inward movement of people into a country. Emigration is the outward movement of people from a country.

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Reasons For Different Rates of Population Growth

- There are two broad **causes of population change**
  - Migration (explained above)
  - Natural population change (birth rates & death rates)

Natural Causes of Population Change

- **Natural change** in population is calculated by **deducting the death rate from the birth rate**

- The following factors led to a decrease in the **death rate**
  - The **agricultural revolution** led to higher yields & healthier, more varied diets
  - Improvements to **medicine & medical care**
  - **Improvements to technology** & transport, leading to a wealthier population which increases **life expectancy**
  - Improved housing & sanitation

- The **birth rate** has remained high in **LEDCs** due to
  - Lack of access to family planning & contraception
  - An increase in **women surviving childbirth**
  - Families continuing to have large numbers of children to **look after their parents** in old age & to help support the family
  - **Culture** of having larger families which takes many years to change
  - **Religious** reasons

- The **birth rate** has fallen significantly in many **MEDCs** due to
  - Increased access to family planning & **contraception**
  - **Changing social norms** which include starting families later, having fewer children, or remaining single
  - Increased costs of child rearing & university education

5.3.2 Effects of Changing Population Sizes

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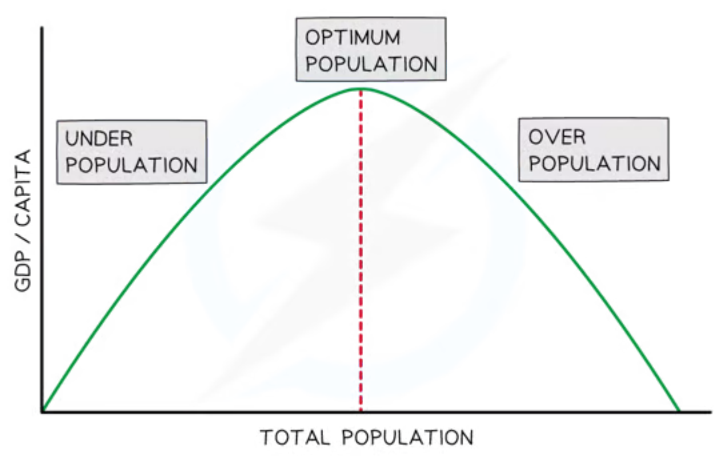
The Optimum Population

- **Overpopulation** occurs when there are more people in a country/region than can be supported by its resources & technology & leads to
  - Higher levels of pollution
  - Higher crime rates
  - Higher unemployment or underemployment
  - Higher levels of **food & water shortages**
  - Higher pressure on services such as hospitals & schools

- **Underpopulation** occurs when there are more resources available than the population can use effectively & may lead to
  - Fewer people paying tax which can lead to higher taxes
  - **Underused resources**, which can lead to wastage
  - A shortage of workers
  - Lower levels of exports & production which affects the wealth of an area
  - Fewer customers for goods & services

- **Optimum population** occurs when there is a balance between the number of people & the resources/technology available



Optimum Theory of Population

- **The optimum population** results in the highest standard of living
  - There are not so many people or so few resources that the standard of living falls
  - There are enough people to develop the resources of the country

Exam Tip

It is important to remember that over-population does not just mean there are a lot of people & under-population that there are few people. The terms refer to the balance between **population & resources**. There may be many people in a country, but it is only over-populated when there are too few resources to support that population.

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Population Distribution

- The **characteristics of a population** (the distribution of age, sex, ethnicity, religion etc), is known as the **population structure**

- **The population structure** is the result of changes in:
  - the birth rate
  - the death rate
  - net migration

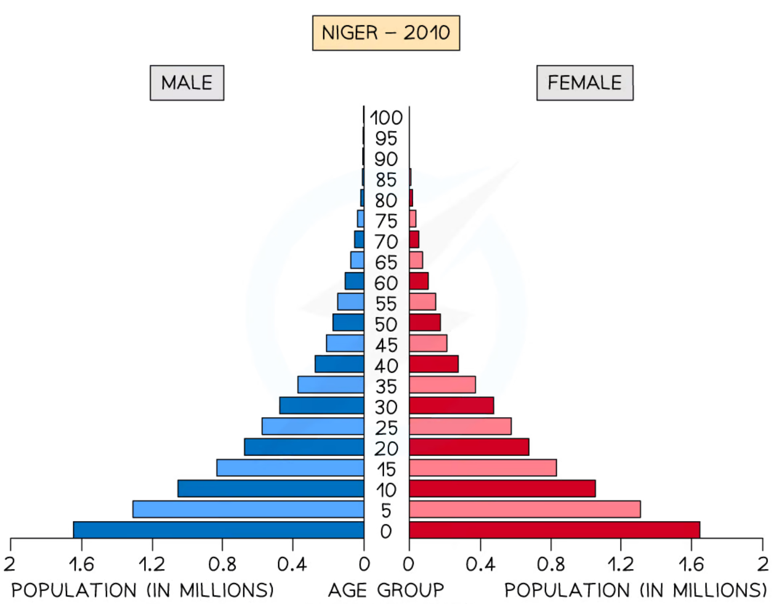
- The two main characteristics of age & sex can be shown on a **population pyramid**

Population Pyramids

- **Population pyramids** are used to display the gender & age structure of a given population
  - They illustrate the **distribution of population** across age groups and between male/female

- **Population pyramids** can be used to identify the following groups:
  - Young dependents
  - Old dependents e.g number of retired people
  - Economically active (working population or **labour force**)
  - **Dependency ratio**

Example 1 - Niger As A Less Economically Developed Country (LEDC)



Population Pyramid - Niger

- LEDCs like Niger have a concave pyramid shape which indicates

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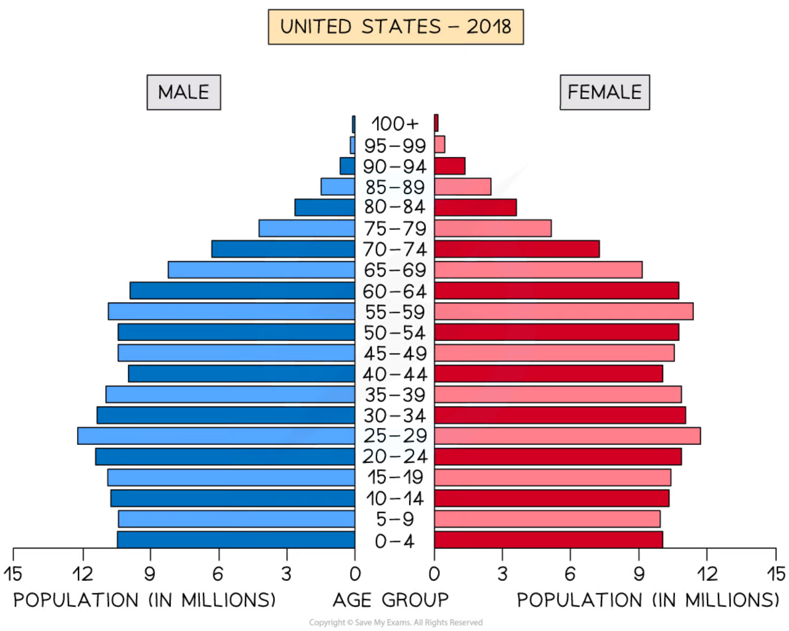
- **High birth rate**
- **Low life expectancy**
- **High death rate** but starting to decrease (people dying through every age group)
- **High infant mortality rate** (significant decrease between 0–5)
- **Young dependent population** dominates the distribution

Example 2 - USA As A More Economically Developed Country (MEDC)



Population Pyramid - USA

- This population pyramid indicates:
  - **Decreasing birth rate** - there is a smaller population reading down from age 29
  - **Increasing life expectancy** - indicated by the relatively straight sides reaching the age of 70, followed by a good proportion of people living much longer
  - **Decreasing death rate** - indicated by the relatively straight sides reaching the age of 70
  - Low infant mortality - hardly any change between 0–9 years
  - **Larger working age population** - 15 to 69 represents a large proportion of the population

Example 3 - Japan As A More Economically Developed Country (MEDC)

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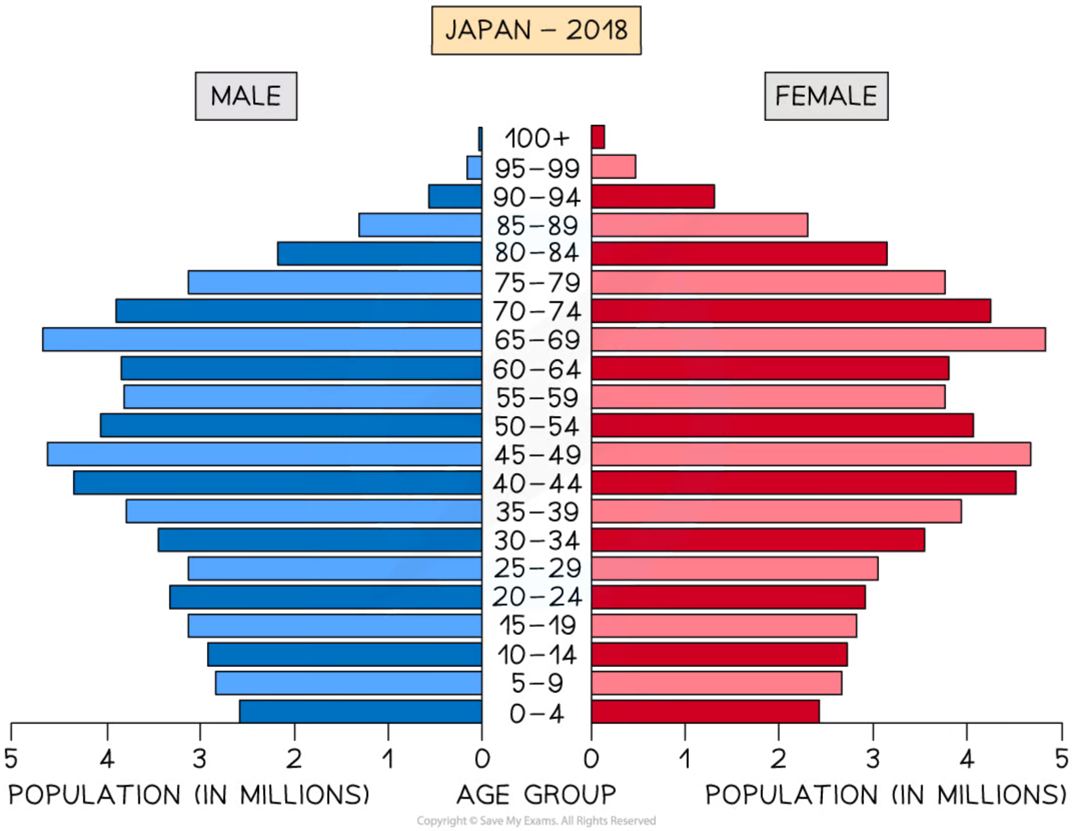

Population Pyramid – Japan

- This **population pyramid** indicates
  - **Decreasing birth rate** – indicated by decreasing population levels from age 29
  - **Increasing life expectancy** – indicated by the relatively straight sides reaching the age of 74, followed by a good proportion of people living much longer
  - **Death rate** is higher than the birth rate due to the ageing population
  - **Low infant mortality**
  - **Ageing population** – older dependent population with large proportion of the population older than 40

Effects of Population Changes

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- **Population changes** can have major impacts within the economy resulting in changes to consumption, production, lifestyle, standards of living & government policies (fiscal, monetary & supply-side)

- Typical changes that occur are
  - Progressively **ageing populations** as economies develop
  - **Falling birth rates** as economies develop
  - **Swings in net migration** as influenced by war, famine, natural disasters & government policy

Ageing Populations

- Many **developed economies** are experiencing ageing populations & an increase in the older dependent population
- The implications of this include
  - Increased pension payments by **governments**
  - Increased need for care homes **(public & private)**
  - Increased pressure on the healthcare service & social care results in higher **government spending**
  - It also results in a **smaller labour force** & often Governments collect less tax
  - Firms suffer worker shortages
  - Labour shortages result in **increased wage costs** for firms

Falling Birth Rates

- Falling birth rates have the following impact on an economy
  - **School closures** due to fewer children
  - Future **labour shortages**
  - Governments typically put in place incentives that **encourage families to have more children**
  - Governments may **change the migration laws** to encourage immigration so that labour shortages are prevented
    - Excessive immigration can **change the nature & culture** of different regions within a country

Migration

- In some countries migration can lead to an **imbalance in the population structure** e.g. the UAE has significantly more males than females
- Rapid population growth caused by **migration** can lead to
  - Increased **pressure on services** such as healthcare & schools resulting in increased costs for government
  - A **shortage of housing** which generates social issues in society
  - **Increased traffic congestion** which is a negative externality
  - Increased water & air pollution which are **negative externalities**
  - Food shortages

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5.4 Differences in Economic Development

5.4.1 Reasons for Differences in Development

Causes of Differences in Development

- **Economic development** is the sustainable **increase in living standards** for a country, typically characterised by increases in life span, education levels, & income
  - Two indicators used to compare development are the **real GDP** & the Human Development Index (see sub-topic 5.1.1)

- **Countries are all at different points of development** & economists distinguish between them using different criteria
  - E.g. **HDI has five categories** of development based on the HDI score
    - Low human development (<0.550)
    - Medium human development (0.550-0.699)
    - High human development (0.700-0.799)
    - Very high human development (>0.800)

- There are **numerous reasons for these differences** including differences in income, productivity, population growth, size of primary, secondary & tertiary sectors, saving & investment, education & healthcare

Causes of Differences in Development

Factor	Explanation
Differences in income	• Countries with a **higher GDP/capita** tend to be more developed • Even with high GDP/capita, there may be significant **inequality in the distribution of income** resulting in poor living standards for many
Differences in productivity	• Differences in **skills** result in difference in productivity • Higher levels of productivity are rewarded with **higher wages**, which leads to a better standard of living
Differences in population growth	• More densely populated countries or cities face more challenges • A larger population can mean **higher tax revenues** for the government but at the same time, government expenditure on services is spread across more people • Poorer economies are characterised by **less government spending/capita**

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Differences in economic sector sizes	• Economies with a **larger proportion** of secondary & tertiary activity tend to be more developed due to the **wages** associated with each sector • **Primary sector** workers are usually paid low wages due to the unskilled nature of the job & the fact that raw materials often generate the lowest profits in the production chain • **Secondary sector** workers **add value** to the raw materials & these products sell for higher profits. Therefore wages tend to be higher than primary sector wages • **Tertiary sector** workers are paid the highest. Their jobs often require highly valued skills that take years to acquire & the products they sell or services they provide can be complex & expensive e.g. artificial intelligence coders
Differences in saving & investment	• Higher savings result in **higher investment & economic growth**. It is believed that as economies develop, savings increase • Increased savings → increased investment → higher capital stock → higher economic growth → increased savings • If the **dependency ratio** is high it means there is less money available for savings & investment
Differences in education	• These directly influence the **level of skill** in an economy • Improved skills results in **higher productivity & wages**
Differences in healthcare	• The level of health directly impacts **productivity of labour** • Productivity influences output & income • **Developed economies** tend to have healthy workforces • The less developed the economy, the **more sickness & disease** there is