Cambridge

IGCSE/O-Level

Economics

(Code: 0455/2281)

Section 04

The basic economic problem

Chapter 32 - Indicators of living standards

A main measure of living standards, however, is still probably real GDP per head. There are also composite indicators such as the **Human Development Index (HDI)** and the **Genuine Progress Indicator (GPI).**

Real GDP per head as an indicator of living standards

An increase in real GDP per head would suggest that living standards have risen, but it may not necessarily indicate the real situation for a number of reasons. One is that real GDP is an average. Not everyone may benefit from a rise in the average income level. The extra income may be unevenly spread with a few receiving much higher income and some not receiving any extra income.

Comparing living standards between countries

Again, one of the main measures is real GDP per head. This measure has the advantage that it takes into account differences in population size and also incorporates adjustments for inflation.

It is for this reason that economists make use of **purchasing power parity (PPP**) exchange rates when comparing countries' GDP. These use an exchange rate based on the buying power of currencies in their own countries.

The Human Development Index

The Human Development Index (HDI) was developed by a team of economists led by Dr Mahbub ul Haq, while he was working for the United Nations Development Programme (UNDP). It has been published every year since 1990.

Other measures

There is a wide range of other measures of living standards. Whilst the HDI is the UNDP's best known measure, it also produces several other measures. Another of the UNDP's measures is the **Gender Inequality Index (GII**) which considers gender-based disadvantage in terms of reproductive health, empowerment and the labour market.

Economists also calculate the **Happy Life Expectancy Index (HLEI).** Bhutan also measures **Gross National Happiness**.

32.2 Comparing living standards and income distribution

Income is unevenly distributed between households in every country, but to diff erent extents. Wealth is even more unevenly distributed. Wealth is a stock of assets which have a financial value. Some of these assets.

Measures of income and wealth inequality

To assess the distribution of income and wealth in a country, economists calculate the percentages of income earned and wealth owned by given proportions of the population. Two common proportions used are deciles (tenths) and quintiles (fifths).

The causes of differences in living standards and income and wealth inequality

Living standards vary between countries and between regions within a country for a large number of reasons.

33.1 Absolute and relative poverty

Absolute poverty occurs when people do not have enough income to pay for their basic needs. They may lack access to, for example, adequate food, clothing, shelter, sanitation and healthcare. People experience relative poverty, when they are poor relative to other people in the country

33.2 The causes of poverty

People can become trapped in a **vicious circle of poverty.** Those who are poor are likely to have worse than average education and healthcare. This will reduce their productivity, employment opportunities and income, and will also affect the prospects of their children.

The Multidimensional Poverty Index (MPI)

One measure of poverty is the Multidimensional Poverty Index (MPI). This index is based on deprivations in education, health and standard of living. Household surveys are undertaken to find,

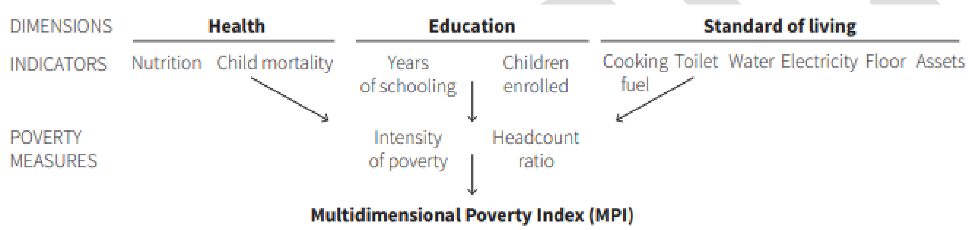

Fig. 33.1: The Multidimensional Poverty Index

Source: United Nations Development Programme, Human Development Reports, Multidimensional Poverty Index (MPI), 2016, hdr.undp.org/en/content/multidimensional-poverty-index-mpi

33.3 Possible government policy measures to reduce poverty

There are a number of measures a government may take in a bid to reduce poverty. Its choice of measures, however, can be restricted by the tax revenue it has raised to fund them. Among the possible measures are:

- Improving the quantity and quality of education
- Promoting economic growth.
- Introducing or raising a national minimum wage.
- Encouraging more multinational companies to set up in the country
- Providing benefits or more generous state benefits.
- Land reform.

Measures to raise living standards

Measures to reduce poverty should also raise general living standards. Improving education and training will enhance the knowledge and earning potential of the people, and their ability to participate in the political system of the country.

Government policies on the distribution of income and wealth

Governments can influence the distribution in a number of ways including:

- taxation
- the provision of cash benefits
- the provision of free state education and healthcare, and
- using labour and macroeconomic policies.

Chapter 34 – Population

34.1 Factors that affect population growth

The size of a country's population can grow as a result of a natural increase or net **immigration**. A natural increase occurs when the birth rate exceeds the **death rate**. For example, the **birth rate** in Iran in 2016 was 15.6 per 1000 and the death rate was 4.6 per 1000, giving a natural rate of increase of 11 per 1000 or 1.1%.

Net immigration occurs when more people come into the country to live (immigrants) than people who leave it to live elsewhere (emigrants).

34.2 The reasons for different rates of population growth

The birth rate is likely to be high when there is a young average aged population in which women marry young, **infant mortality rate** is high, women are not well-educated, most women do not work and it is cheap to bring up children.

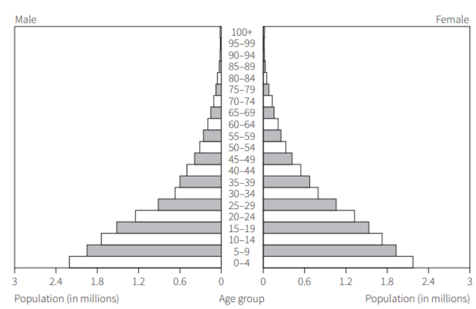

Fig. 34.1: Population pyramid, Mozambique, 2016
Source: CIA World Factbook

The rate and pattern of **net migration** is influenced by relative living standards at home and abroad, persecution of particular groups and extent of control on the movement of people.

34.3 The effects of changes in the size and structure of populations

Population structures

Diagrams in the form of bar charts, referred to as **population pyramids**, show a more detailed breakdown of the different age groups. The traditional view of the population pyramid of a country with relatively low development is a pyramid shape such as that shown in Figure 34.1.

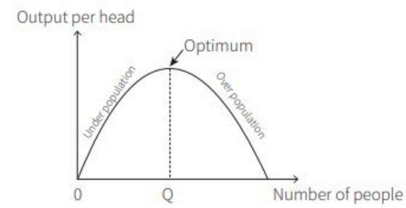

Fig. 34.3: The concept of optimum population

The age structure of a population influences its **dependency ratio**. This is the:

$$\frac{\text{Number in dependent age groups}}{\text{Number in the labour force}} \times 100$$

The dependant age groups are those below school leaving age and those above retirement age.

The optimum population

The term **optimum population** refers to the number of people which, when combined with the other resources of land, capital and existing technical knowledge, gives the maximum output of goods and services per head of the population

The effects of an increase in population

Possible benefits of an increasing population are listed below:

• If the population is below the optimum size, the country will be able to make **better use of its resources.**

• The **size of markets will increase**. This should enable firms to take greater advantage of economies of scale.

• There may be an **increase in factor mobility** if the rise has resulted from an increase in the birth rate or immigration. Expanding industries can recruit new workers to the labour force.

• Extra demand will be generated. This is likely to stimulate investment and this may lead. To the introduction of new technology.

• A **rise in the labour force** now due to net immigration and in the future, caused by a rise in the birth rate. Net immigration will bring in more workers.

Despite the possible advantages of an increasing population, there are a number of reasons for a government to be concerned about population growth.

These include:

• Concerns about famine

• Restrictions on improvements in living standards

• Overcrowding.

• Environmental pressure.

• Environmental pressure

• Balance of payment pressures

Ways of reducing the birth rate

A country concerned that its population is growing too rapidly would not want to raise its death rate! It may however, seek to reduce immigration and try to reduce the country's birth rate. There are a number of ways it could do the latter. An effective way is thought to be improvement of the educational and employment opportunities for women.

The consequences of an ageing population

An ageing population can be caused by a fall in the birth rate, a fall in the death rate, net emigration or a combination of the three. There are a number of consequences of an ageing population including:

• A rise in the dependency ratio. If people are living longer and there are fewer workers because of net emigration, there will be a greater proportion of consumers to workers.
• A change in the labour force. Older workers may be geographically and occupationally less mobile. They may, however, be more experienced, reliable and patient.

• Higher demand for healthcare. The elderly place the greatest burden on a country's health service.

• Greater need for welfare services, such as caring for the elderly at home and in retirement homes.

• Rise in cost of state and private pensions.

• Change in the pattern of demand. For example, demand for housing for retired people will rise.

Ways of coping with an ageing population

Having a higher proportion of elderly workers will put pressure on governments to spend more. If they do so, it will involve an opportunity cost. The money used, for example, may have been spent on education instead. An ageing population may also raise the tax burden on workers

Internal migration

Workers tend to migrate from rural to urban areas in search of better jobs and higher incomes. Such migrants may supply growing industries and result in a better allocation of resources. Their movement may also raise living standards in rural areas if initially there had been underemployment and if they send back money to their relatives. There may, however, be some harmful effects also

The effects of net emigration There are a number of possible economic effects of net emigration. These are influenced by the size and the nature of the emigration. Some of these include:

• The size of the working population is likely to be reduced. Most emigrants tend to be of working age.

• The remaining labour force will have a greater burden of dependency.

• The average age of the labour force will increase. This may make it less mobile.

• The gender distribution of the population may be affected. In the case of some countries, more men emigrate than women.

• There may be a shortage of skilled workers. For example, doctors may emigrate in search of higher pay and better working conditions. The country they leave will experience a 'brain drain', while the country they go to will experience a 'brain gain'.

• There may be under-utilisation of resources. The country may become under-populated.

• Those who emigrate may send money home to help their relatives. This money is called workers' remittances.

Chapter 35 - Differences in economic development between countries

35.1 Economic development

Economic development is wider than economic growth. Besides improved living standards, it also involves reducing poverty, expanding the range of economic and social choices, and increasing freedom and self-esteem. As an economy develops, the economic welfare of its population increases.

The different stages of economic development

Most economies are developing, but their rate and level of development varies. Countries with high income per head also usually have relatively high economic development. They tend to have high living standards, a high proportion of workers employed in the tertiary sector, high levels of productivity and high levels of investment.

Measures of economic development

It is not easy to measure development, but a number of ways are used. A common one is real GDP per head. This does measure an important aspect of development, material living standards, but it does not measure all aspects of development.

35.2 Causes of differences in economic development between countries

There are a number of reasons why countries have different levels of economic development including:

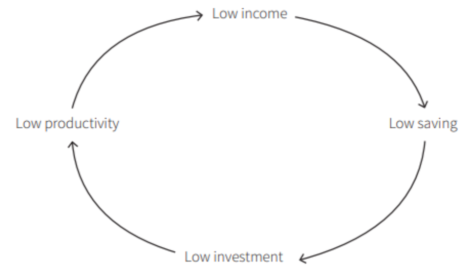

Fig. 35.1: The vicious circle of poverty

- Differences in incomes per head.
- Differences in saving due to differences in income per head
- Differences in investment.
- Differences in population growth.
- Differences in education and healthcare
- Differences in the size of the primary, secondary and tertiary sectors.
- Differences in the concentration on a narrow range of exports (most of which are primary products)
- Differences in productivity.

Why governments seek to achieve economic development

Governments pursue economic development because they want higher real GDP, higher living standards for their citizens and expansion of the range of economic and social choices.

Economic growth has the potential to raise material living standards. If higher real GDP consists of both more consumer and capital goods the country's population should be able to enjoy more goods and services, both now and in the future.

The conditions for economic development

Most economists agree that for economic development to occur, there needs to be an improvement in the quantity and quality of resources.

35.3 The impacts of differences in economic development between countries

Countries develop at different rates at different times. These differences have implications for both them and for other countries.

The problems facing economies with relatively low economic development

Economies with relatively low economic development may face a number of difficulties in seeking to improve their economic performance and living standards. These include:

- High growth of population.
- High levels of international debt
- Reliance on the export of primary products.
- Lack of investment in human capital and capital goods
- Emigration of key workers
- Trade restrictions on their products.
- Unbalanced economies.

Measures to promote economic development

There is some disagreement about the best ways to promote economic development, for instance, whether it is better to rely on government intervention or market forces operating in the private sector, whether countries should rely on domestic or foreign sources of investment funds. One strategy, which involves government intervention, is what is called import substitution. This involves the protection of new domestic industries against foreign competition by the government.

How the economic development in one country can promote economic development in another country

In an increasingly global market, the events in one economy have a greater impact on other economies. For instance, a buoyant UK economy would be likely to benefit Tanzania, while an improvement in the Tanzanian economy should bring some advantages to the UK. If the UK economy grows, the UK government will receive more tax revenue and this will enable it to increase its foreign aid, some of which may go to Tanzania.