chapter 8

Development economics

8.1 Defining economic development and the role of development economics

It is a sad fact that, for around 60 per cent of the world’s 7.4 billion people, life is a real struggle and living standards are low. Indeed, it is surely a great obscenity that many people in high-income nations grow obese from endless consumption, while those in low-income countries suffer great physical deprivation, poverty, hunger, inequality, insecurity, poor health, illiteracy, persecution, and the absence of hope and opportunity. Here, we think of the low-income countries in Africa, parts of Asia and South America. The world map in figure 8.1 (p. 314) shows all countries classified by whether they are low income (shaded in brown), lower middle (in light brown), upper middle (in light green) or high income (in dark green). By way of definition, in 2014, the World Bank defined low-income countries as those where people subsist on a mere $2.80 or less per day (i.e. an average of $1035 per person a year or less), as opposed to high-income countries where average incomes are over $12,616 per person a year. In addition, figure 8.2 (p. 314) reveals the staggering differences in world consumption levels by high-, middle- and lower-income countries, while figure 8.3 (p. 314) displays the percentage of the world’s population living below different poverty lines (income measured at $1.25, $2 and $10 per day). Notice that using $1.25 per person per day ($456.25 per person per year) as the poverty line, around 15 per cent of the world’s population is now classified as living in extreme poverty.

High-income nations are currently defined as those where average incomes are over $11,456 per person a year. Low-income countries are those where people subsist on a mere $2.80 or less per day and where, typically, there is great physical deprivation, poverty, hunger, inequality, insecurity, poor health, illiteracy, persecution, and the absence of hope and opportunity.
FIGURE 8.1 Countries classified according to their average income per person a year.
Source: Data rounded and derived from World Bank, Development Indicators (2014).

FIGURE 8.2 How the world’s consumption is shared between countries.
Sources: Data rounded and derived from World Bank, Development Indicators (2008), and Global Issues, ‘Facts and stats’, 22 March 2009.

FIGURE 8.3 The percentage of the world living below the poverty line of $1.25 and at other levels of daily income.
Sources: Data rounded and derived from World Bank, Development Indicators (2008), and Global Issues, ‘Facts and stats’, 22 March 2009.
This chapter is about development economics. Development economists try to understand the obstacles that slow improvements in general living standards in low-income countries. Armed with this knowledge, they then use theories to suggest practical strategies and policies that aim to accelerate economic development.

The term development, however, is quite hard to define, and its meaning has changed significantly over the past 30 to 40 years. Until the 1970s, it was taken purely in the economic sense. In other words, economic development in low-income countries simply involved growing the size of their economies or GDPs between one year and the next (preferably at a faster rate than the rise in their population). With each person having access to more goods and services, or higher average incomes, it was felt that society would generally be better off economically. You may recall from chapter 2 that economic growth (and improved material living standards) ultimately involves expanding the nation’s productive capacity. This means shifting the production possibility frontier (PPF) outwards and to the right, as shown in figure 8.4 below, through improvements in the volume or efficiency of resources.

Development economics uses economic theory to come up with practical strategies and policies designed to increase development and improve the overall living standards of people in low-income nations.

Development is nowadays seen as the economic, social, political and institutional changes needed in low-income countries to improve material and non-material elements affecting the quality of daily life.

In other words, by promoting economic growth, it was believed that this would lead to more development and generally better living standards. It was assumed that the benefits of this process would eventually trickle down and help ordinary people have better lives, by creating employment and higher incomes, reducing poverty and illiteracy, lifting health and extending life expectancy.

By the early 1980s, this rather narrow view about development had changed. Development economists still thought that promoting economic growth and increased productive capacity were very important for development, but it was only one of several things needed to radically improve the daily lives of billions of people. This change in definition occurred because, despite good economic growth in some low-income countries, general living standards for most remained pathetically low with much poverty, malnutrition, unemployment, illiteracy, low life expectancy, poor health, inequality, repression of freedom and limited opportunities. It was finally realised that economic development involved not just economic progress, but also broader changes to social, political and institutional frameworks. Interestingly, at this time, economists and others in the United Nations and elsewhere were developing new...
measures of a nation’s success. One of these is called the human development index (HDI). Another more recent measure of progress is through the achievement of the UN’s millennium development goals. As we shall see soon in section 8.2, these and other indicators of progress have helped create a broad definition of development. It is now defined as the economic, social, political and institutional changes needed in low-income countries to improve material and non-material aspects affecting the quality of daily life.

8.2 Measurement of development

We now know that development refers to the economic, social, political and institutional changes needed in low-income countries to improve material and non-material aspects affecting the quality of daily life. Measuring development is not as easy as it might seem, especially if it is condensed into a composite or single statistical indicator (as opposed to using a broad range of measures).

GDP as a measure of development

Traditionally, development was measured by the growth in the average level of gross domestic product per capita (i.e. the annual value of GDP or national production divided by the total population size). It was thought that increases in this indicator would eventually lead to generally higher incomes, increased consumption, reduced poverty rates and better material living standards. However, although this measure does tell us something about changes in a country’s average living standards, it is very limited for the following reasons:

• The problem of unrecorded subsistence production. GDP only measures the value of goods and services produced and exchanged in the economy. Because a large percentage of the population in low-income countries is involved in subsistence production that is never marketed or sold, GDP per capita is likely to be an underestimation of actual levels of economic welfare.
• The problem of distribution. Average GDP per capita fails to take account of how evenly or unevenly goods, services and incomes are distributed or shared among all members of the population. Most low income countries have extreme inequality, where the poorest 20 per cent of the population receives perhaps less than 4 per cent of the nation’s income cake. Average GDP per capita is, therefore, a very inadequate guide of people’s access to basic goods and services.

• Negative externalities. On its own, GDP does not consider the costs to society and the environment (i.e. called negative externalities) of production or economic progress, yet such costs are often very high in low-income countries due to overpopulation.

• No consideration of the quality of daily lives. Importantly, GDP fails to accurately tell us whether the daily lives of ordinary people are getting better in terms of life expectancy, health, access to clean water, standards of food and nutrition, poverty rates, justice, freedom and democracy, security, human rights, opportunities for women, education and literacy.

Hence, while the level of GDP per capita is very important for our wellbeing, economists need to use much broader measures of development. One of these is called the human development index.

The human development index as a measure of development

These days, the human development index (HDI) is the most widely used measure of the level of development. Each year, the United Nations Development Program calculates an HDI for most countries and then ranks these from highest to lowest (using a scale where 1.00 equals the highest and 0.00 the lowest level of development). Data is published annually in the Human Development Report. As outlined below, the HDI is constructed to reflect both economic and social indicators:

• The economic indicator used in the HDI. As expected, GDP per capita (similar in meaning to average income per person) is included in the HDI. However, this figure is adjusted or standardised to remove variations in the actual purchasing power of money in different countries (called purchasing power parity or PPP, expressed in US$).

• Social indicators used in the HDI. Two key social measures of economic development are also used in the HDI including life expectancy (calculated at birth and expressed in years) and education standards (shown by adult literacy rates expressed as a percentage of those aged 15 years and over and by the combined secondary and tertiary school enrolments).

International comparisons of economic development

Figure 8.6 (p. 318) shows the HDI for selected countries. However, while acknowledging that the HDI is much better than using only average GDP per capita as an indicator of development, the measure has its critics. Perhaps the main weakness of this indicator is that it is impossible to accurately condense the many dimensions of development for a country into a single figure that is internationally comparable. They note that the HDI is too simplistic because only three aspects of development are taken into account and GDP per capita, with all its flaws, is still one of these elements.

Millennium development goals and their measurement

In September 2000, 189 countries agreed to eight key Millennium Development Goals (MDGs) proposed by the United Nations for achievement by the year 2015. In turn, these eight goals are broken down into 21 targets that can be measured using 60 indicators of people’s wellbeing and daily existence (this broader approach to measurement differs from the single index approach used in GDP or the HDI). The eight basic goals (and how they are measured) are outlined in figure 8.7 (p. 319).

Recently, a UN report was prepared covering the first 10 years of the plan. It showed significant progress in achieving some of the UN’s development goals. For instance, the aim of halving global poverty rates (i.e. those living on less than US$1.25 per day in PPP terms) has now been achieved as shown in figure 8.8 (p. 319), but this has been especially due to progress in Asia rather than in Africa.
Ranked comparisons of human development indexes in selected countries or regions for 2012
(where an index of 0.00 is the lowest and 1.00 is the highest)

<table>
<thead>
<tr>
<th>Country</th>
<th>HDI Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Congo Democratic Republic (world rank, no. 187)</td>
<td>0.304</td>
</tr>
<tr>
<td>Niger (world rank, no. 186)</td>
<td>0.304</td>
</tr>
<tr>
<td>Mozambique (world rank, no. 185)</td>
<td>0.327</td>
</tr>
<tr>
<td>Ethiopia (world rank, no. 173)</td>
<td>0.396</td>
</tr>
<tr>
<td>Zimbabwe (world rank, no. 172)</td>
<td>0.397</td>
</tr>
<tr>
<td>Rwanda (world rank, no. 167)</td>
<td>0.434</td>
</tr>
<tr>
<td>Uganda (world rank, no. 161)</td>
<td>0.456</td>
</tr>
<tr>
<td>Least developed countries</td>
<td>0.466</td>
</tr>
<tr>
<td>Low income countries</td>
<td>0.554</td>
</tr>
<tr>
<td>India (world rank, no. 136)</td>
<td>0.554</td>
</tr>
<tr>
<td>The world</td>
<td>0.682</td>
</tr>
<tr>
<td>China (world rank, no. 101)</td>
<td>0.699</td>
</tr>
<tr>
<td>Saudi Arabia (world rank, no. 57)</td>
<td>0.782</td>
</tr>
<tr>
<td>High income countries</td>
<td>0.905</td>
</tr>
<tr>
<td>USA (world rank, no. 3)</td>
<td>0.937</td>
</tr>
<tr>
<td>Australia (world rank, no. 2)</td>
<td>0.938</td>
</tr>
<tr>
<td>Norway (world rank, no. 1)</td>
<td>0.955</td>
</tr>
</tbody>
</table>

FIGURE 8.6 International comparisons of the human development index for selected countries.

The Millennium Development Goals (MDGs) are a set of global development objectives to be achieved by 2015 that were unanimously adopted at the United Nations Millennium Summit in September 2000. They represent an unprecedented global unifying force for reducing poverty and improving human development. Progress towards the goals is measured against a number of targets, shown here, which were developed during and after the Summit.

1. **End Poverty and Hunger**
   - Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day.
   - Achieve full and productive employment and decent work for all, including women and young people.
   - Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

2. **Universal Education**
   - Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

3. **Gender Equality**
   - Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015.

4. **Child Health**
   - Reduce by two thirds, between 1990 and 2015, the under-five mortality rate.

5. **Maternal Health**
   - Reduce by three quarters the maternal mortality ratio.
   - Achieve universal access to reproductive health.

6. **Combat HIV/AIDS**
   - Have halted by 2015 and begun to reverse the spread of HIV/AIDS.
   - Achieve, by 2010, universal access to treatment for HIV/AIDS for all those who need it.
   - Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases.

7. **Environmental Sustainability**
   - Integrate the principles of sustainable development into country policies and programmes and reverse the loss of environmental resources.
   - Reduce biodiversity loss, achieving, by 2010, a significant reduction in the rate of loss.
   - Halve, by 2015, the proportion of the population without sustainable access to safe drinking water and basic sanitation.
   - By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

8. **Global Partnership**
   - Targets cover: trading and financial systems, the special development needs of disadvantaged states, debt sustainability, affordable access to essential drugs and access to information and communications technologies.

**FIGURE 8.7** Summary of the UN’s Millennium Development Goals for 2015


1. What is gross domestic product (GDP) per head? What are three main weaknesses of this as a measure of development?
2. What is the human development index (HDI)? How is it measured? What is the main weakness of this as a measure of development?
3. Identify and outline the eight key Millennium Development Goals (MDGs) adopted by the UN. To what extent have these goals been achieved?

**FIGURE 8.8** Trends in the reduction of extreme poverty by global region

Source: Graph copied directly from World Development Indicators 2014, p. 2, published for the World Bank.
There was also good growth in universal education, a reduced incidence of HIV and AIDS, and lower child (under five years of age) mortality rates (now below 10 million per year). However, there were significant differences between countries, and given the trends to 2014 and the GFC and ensuing recession, some goals look unachievable, especially improved maternal health, gender equity, environmental sustainability and international financial aid or support.

Try applied economic exercise 2, pp. 339–40

8.3 Causes of poverty in low-income countries

There are many theories used to explain why some countries experience extreme poverty and some countries don’t. One theory was provided by an American economist, Walt Whitman Rostow, who published a book entitled the *Stages of Economic Growth*.

**Stages of economic growth**

Rostow suggested that economic growth and development move through five main stages as seen in figure 8.9 below.

![Figure 8.9 Rostow’s stages of economic growth](image)

Rostow’s theory suggests that countries must move through these stages to avoid poverty and achieve stage 5 where strong living standards are enjoyed. While some countries have followed this path of development and achieved high incomes, Rostow’s critics say that his explanation is too simplistic. It leaves out important influences. Alternative theories have also been proposed to help explain the process of economic development. Some of these emphasise the need for structural change in low-income economies including the shift of labour from agriculture to manufacturing. Others have emphasised the importance of a market-based approach involving profit incentives and reduced government restrictions to bring about change, while some economists see international cooperation and trade as the key driver of development.

Unfortunately, there is no simple explanation for the causes of poverty that suits all cases, since each country is unique in certain ways. For instance, some nations have big populations, others are small. Some have many natural resources, others have few. Some have socialist economies, others use market capitalism. Some are on different sides of the equator. And some are former European colonies, but others are not. However,
having pointed out some of the differences, it is possible to make a few generalisations about the factors that commonly restrict economic development and cause poverty in low-income countries.

**Factors that may cause poverty in low-income countries**

Let us now look at the factors that restrict economic development and cause poverty in some countries.

**The problem of limited productive capacity**

Perhaps the most common cause of poverty in low-income economies is their lack of productive capacity. This restricts the level of output of goods and services, relative to the size of the population. It means that each person’s income and slice of the production pie is small. As a result, average consumption of goods (e.g. food, clothing, housing) and services (e.g. health, education, transport) per capita is low. This causes poverty and subsistence living standards. Mention has already been made as to why the country’s capacity or production possibility frontier may be limited (see p. 315 and figure 8.4). Basically, it comes down to two main things.

1. The volume of natural (e.g. agricultural land, climate, water), labour (e.g. the provision of skills and physical effort) and physical capital resources (i.e. plant and equipment used in production, such as tractors, railways, electricity system) per person in low-income countries is too small to allow for sufficient production or GDP. Perhaps the country is overpopulated given the quantity of resources available.

2. The level of productivity or efficiency per worker (i.e. perhaps measured by the average level of GDP per hour worked) is low in economically poor nations, thereby restricting productive capacity. That is, the output of goods and services produced per unit of input is very small. The problem with limited efficiency and production per hour is that incomes paid to workers are low. This causes poverty, malnutrition, poor health and limited opportunities. Clearly, poverty and lack of development will persist in these countries unless there is some economic growth and the expansion of the nation’s production possibility frontier (PPF).

**Low saving and investment create poverty**

As we know, Third World nations have low subsistence levels of production and income and, hence, high levels of poverty. After purchasing basic necessities (e.g. food, housing), little or no household income remains for saving (i.e. saving is income not spent). However, without saving (by households, firms or governments), there is limited finance for investment in capital equipment that is needed to start and grow businesses or provide government services or infrastructure, unless there is a rise in overseas borrowing or debt.

Even if credit is available in low-income countries, it is very expensive as reflected in high interest rate repayments up to 40 per cent. These higher interest rates make starting private businesses almost impossible as the repayments will eat into any possible profit. Many households also lack the basic requirements for gaining a credit rating so that they are eligible for borrowing from banks or local money lenders. In addition, if governments borrow to provide community services (as happens in some low-income countries), there is the ongoing burden of interest repayments for future generations.

Whatever the cause, low levels of investment in equipment and new technology mean that labour output per hour worked (i.e. efficiency) is very small indeed. This causes hourly pay rates, incomes and purchasing power to be limited and hence living standards remain desperately low. One way to illustrate this problem is to use a diagram showing the vicious cycle of poverty. As shown in figure 8.10 (right), the poverty cycle can start with poor savings, inadequate investment, weak efficiency and hence low incomes, which will persist unless the cycle is somehow broken. However, escaping this vicious cycle is not easy. As we shall see shortly, it may take considerable time and requires a combination of many strategies.
Problems involving population and the labour force

On average, the population of low-income countries is growing more than three times as fast than those of high-income countries. For instance, for economically poor countries, the average rate of population growth is around 2.2 per cent a year, as against only 0.7 per cent in most richer countries.

Many factors contribute to rapid population growth such as the tradition of having large families (to counteract high infant mortality rates), restricted access to birth control (due to cost or religious beliefs) and a lack of information about birth control and family planning (see figure 8.12 below). In addition, extra children are often seen by parents as an insurance against old age since they can earn extra income for the family (given that child labour is usually tolerated).

There are many influences on the rate of population growth. Figure 8.12 below summarises some of these causes of rapid population growth in low-income countries, and outlines some of the effects.

Rapid population growth places enormous pressures on the resources of poor countries. It does this in several ways:

- **Farming problems.** Given that most families live in rural rather than in urban areas, the size of farms and the ability of rural populations to feed themselves and create...
jobs, is progressively reduced by population growth. Farmers are forced onto less fertile land, so efficiency and incomes decline. This problem is worsened by the fact that, often, the best land is owned by the rich minority, who either fail to cultivate the property or, alternatively, impose harsh rental conditions on farmers (i.e. 50–80 per cent of the crop is taken by the landlord as rent). This contributes to low productivity and higher unemployment. It also means that productive capacity is wasted and the nation’s output of food is lower than it could be. As a result, living standards are depressed to subsistence levels and poverty rates rise.

- **Urban problems.** In some developing countries, population growth has meant that there has been a massive shift of people in search of work from overcrowded rural areas into the city where there are some jobs available in manufacturing. This creates severe urban problems involving inadequate transport, housing, waste disposal, pollution, sanitation, education, water supply and health services.

- **Infrastructure problems.** Usually, governments in low-income countries are expected to provide infrastructure and services such as education, health, water supply, sanitation, roads, railways, ports and electricity. However, government tax revenue is inadequate to provide these, due to low incomes, unemployment, corruption and tax evasion. Rapid population growth puts pressure on infrastructure that is already insufficient. It breaks down, is chaotic, congested, decaying and inefficient. Apart from causing people to live in miserable conditions, poor infrastructure also scares away new businesses. This means that production is depressed, there are fewer jobs, and incomes are lower than otherwise.

- **Unemployment problems.** In many low-income countries, rapid population growth increases unemployment (i.e. when those 15 years of age and over who want work cannot find jobs). Figure 8.13 (p. 324) shows the massive scale of this problem with rates in some countries up to 40 per cent of the labour force. In addition, there is the issue of underemployment (i.e. when those working are not employed to their capacity and, for example, could work more hours and produce more output per hour). Commonly, those who are employed are only working at perhaps 50–60 per cent of their potential. Together, unemployment and underemployment mean that a very large part of the country’s labour resources are idle, and its economy is operating well below capacity and inside its PPF. As a result, production and income levels per head of population are low and poverty is rampant.

- **Problems in education and skills.** Potentially, people are one of the most valuable economic resources for any nation. Although low-income countries often have large labour forces, unfortunately most are unskilled. Illiteracy and the lack of access to information, new ideas, technology and skills means that agriculture, manufacturing, services and administration all remain backward. Poor education standards slow economic development and contribute to poverty. Table 8.1 (p. 324) shows the sharp contrasts in educational indicators for low-income countries, as compared to high-income countries such as Australia.

There are many reasons for inadequate access to education. For example, given rapid population growth and limited finance, governments simply cannot provide sufficient schools and trained staff. In addition, a common expectation and necessity is that children work from an early age and contribute financially to the family.

- **Environmental problems.** Generally, more people means that there is greater pollution. This is because of the need to increase the production of goods and services. It often means that natural resources are overused and abused, resulting in environmental degradation. For example, to allow for the growth of agriculture to feed growing populations in Indonesia and Brazil, logging and the clearing of forests have occurred on a massive scale. This has led to the destruction of native habitat, extensive soil erosion, reduced water and river quality, and increased risk of mud slides that destroy villages and infrastructure. Again, poverty is increased and living conditions become more depressed.

### The problem of inefficient government and other institutions

**Democracy** involves giving people the freedom every few years to choose who will govern them. Often low-income countries have dictatorships and democracy fails to thrive. Ordinary people are usually powerless to judge or comment about poor government. The media is unable to expose rampant corruption and administrative failure, and vital economic and social change cannot occur. This slows development and
incompetence by government goes on, unchecked. Too often, for example, officials look after themselves, protect their friends, hand out special privileges to interest groups and fail to use policies to redistribute income and equitably share the benefits of economic development. In addition, it is not uncommon in low-income countries with military dictatorships for scarce resources to be redirected, away from providing basic community services and infrastructure, into defence spending. Sometimes this is even financed using foreign borrowing involving expensive debt repayments. This lowers economic development and adds to poverty.

![Unemployment rates in low income and other countries and regions](image)

**TABLE 8.1** Indicators of education standards in low- and high-income countries

<table>
<thead>
<tr>
<th>Indicator of educational standards</th>
<th>Low-income countries</th>
<th>High-income countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adult literacy rate (percentage of those aged 15 years and over)</td>
<td>60</td>
<td>95</td>
</tr>
<tr>
<td>Combined enrolment ratio (total percentage in primary and secondary, and tertiary education)</td>
<td>56</td>
<td>92</td>
</tr>
</tbody>
</table>

Problems of limited foreign trade and rising debt

Countries need to export in order to help pay for necessary imports. They also have to meet the burden of paying interest on their foreign debt or overseas borrowing. Unfortunately, there are many obstacles preventing low-income countries from being able to pay their way in international financial transactions with the rest of the world. As a result, most low-income countries have large deficits on their balance of payments current account, and massive levels of foreign debt. Let us take a closer look.

- **Limited agricultural exports.** It is common to find a large proportion of the population in low-income countries involved with subsistence agriculture. This obviously produces no surplus output to boost export sales and incomes. However, often the other more modern part of the rural sector produces for local and, especially, export markets. It entails growing cash crops and other food items (e.g. cocoa, sugar, coffee, spices, maize, timber, palm oil and rice). Unfortunately, there is little value added in this line of industry (due to the lack of processing) and so many of their commodities command only low prices internationally. Furthermore, high-income countries including the United States, Switzerland, Japan and the European Union, use tariffs and subsidies to protect their own rural industries. This all means that export incomes of poor countries are fairly low, and many nations face large CADs and rising foreign debts.

- **Limited manufactured exports.** There is a growing need in low-income countries to focus on basic manufactured exports (e.g. textiles and clothing, toys, simple electrical goods) produced in urban areas. This is often because opportunities and land for farming are limited, rural commodity prices are depressed, and incomes are low. As a result, unemployed or underemployed labour drifts to the cities in search of jobs in manufacturing. However, these countries’ exports of simple manufactured or processed goods are often reduced by the existence of substantial tariffs, import quotas, export subsidies and other protectionist tricks used by high-income countries.

- **Increased reliance on imports.** Often there is a reliance on imports of food, oil and more elaborately manufactured items (e.g. equipment) because of obstacles that restrict domestic production in these areas. This adds to a country’s current account deficit.

- **The problem of overseas debt repayments.** There are many reasons why many low-income nations have high levels of foreign debt and problems with debt repayment. For instance, savings levels are usually low. This scarcity of savings causes local interest rates to be high, making finance for investment spending on capital equipment very expensive. Third World debt is also worsened by the fact that interest rates abroad are often lower than those offered locally. In addition, generous credit was previously made available at very seductible interest rates, sometimes by multilateral institutions like the International Monetary Fund (IMF) and World Bank. Governments in low-income countries often face serious financial problems, driving them into debt. On the one hand, the government’s economic worries are caused by inadequate revenue. As noted previously, this is due to subsistence or low average incomes of the population and tax collection difficulties including corruption and institutional failings. On the other hand, with rapid population growth, the required level of government spending on providing basic social and economic infrastructure (e.g. services including health, education, transport, water supply, power generation) is massive. In addition, often the borrowed money has been misappropriated through corruption, wasted by incompetent officials on poorly selected projects, and misused for financing repression and military operations (i.e. around 20 per cent of Third World debt was spent on military equipment).

A seemingly attractive solution to this problem is for the private and government sectors to finance their spending by borrowing credit overseas. Unfortunately, this adds to the foreign debt of low-income countries. As shown in figure 8.15 (p. 326), public sector debt levels, much of it borrowed overseas, in many low-income countries like Lebanon or Zimbabwe are very high, when compared with the size of their economy or GDP. One would have to question the capacity of these countries to ever repay the loans, without causing much pain and suffering.
The other problem is that, sometimes, interest repayments amounting to billions of dollars annually, mean that government spending on necessary community services (e.g. health, housing and education) and infrastructure (water supply and transport) must be cut dramatically. This then contributes to even more poverty and depressed living standards. Perhaps we can now see why forgiveness of debt, offered by high-income countries in recent years, may allow struggling nations to make a new start and alleviate poverty. Although borrowing credit clearly has its dangers, moderate levels of government debt can be handy, provided that credit has been used productively for financing important projects that add to the nation’s self-sufficiency and the quality of daily life for ordinary people.

**FIGURE 8.15** The problem of public sector foreign debt (much of it borrowed overseas) in selected low-income countries

*Sources:* Data derived from and then calculated using CIA, *The World Factbook*

*Note:* Most data is for 2013

### The problem of inequality in income and wealth

The gap in income and wealth between the rich and poor in low-income countries is even greater than it is in Australia. The Gini coefficient (see explanation chapter 4, pp. 135–8) is often used to measure the levels of inequality. It is a number between 0.0 (meaning total equality) and 1.0 (meaning total inequality). As shown in figure 8.16 (p. 327), the Gini coefficient in many low-income countries (e.g. Namibia, Central African Republic, South Africa, Botswana and Lesotho) is often very high, between 0.5 and 0.7.

By way of contrast, Australia’s Gini for income is around 0.3 (i.e. relatively more equal). Frequently, inequality is reinforced by unequal ownership of land, official corruption, the absence of democracy and free speech, military dictatorship, closed markets, state and private monopolies, the caste system that ranks society, special favours involving deals with the government, and the abuse of social, political and economic power. In addition, undemocratic governments in these countries often do not have a real commitment to promoting a fair or equitable income distribution. As a result, the rich tend to get richer, the poor get poorer, poverty thrives and living standards remain low.
Historical problems

One thing that many low-income countries have in common (e.g. Africa, South America, Asia, Central Europe) is that during the 1700s, 1800s and early 1900s, they were colonies of European powers. Many of these nations were exploited for their cheap and obedient labour and for their natural resources. In the past, much wealth and income was sucked out, often leaving the local population worse off than before. It is hardly surprising, therefore, that most of these countries (e.g. India, South Africa, Indonesia, Vietnam and East Timor) pushed for independence through both peaceful

1 Outline how the existence of each of the following problems in many low-income countries might lead to poverty.

a The problem of limited productive capacity
b Low saving and investment levels
c Rapid growth in the population and size of the labour force
d The problem of inefficient government and other institutions
e Problems of limited foreign trade and rising overseas debt
f The problem of inequality in the distribution of income and wealth
g Historical problems.
and other means. In some cases, the end of European colonialism did not mean the end to poverty.

Try applied economic exercise 3, p. 340

Try analysis of visual evidence — a cartoon, p. 343

8.4 Strategies to promote economic growth and development

With so much suffering in low-income countries, there is a desperate need for effective government policies to help accelerate economic development. Policy that aims at accelerating economic growth so output rises at a faster rate than population is important for poor nations (although not the only solution).

To accelerate economic development, one starting point is that there needs to be an increase in a nation’s productive capacity (i.e. size of the PPF) through access to more resources, or especially by using existing resources more efficiently. As we know, the problem here is that many poor countries have very limited resources and use them inefficiently. The task then is to find government policies and other strategies to help overcome these obstacles. Let us take a closer look at some possible solutions.

Policies to lift investment levels

As mentioned, Third World nations have low subsistence incomes and high poverty rates. Savings (income or money not currently spent or consumed) are simply inadequate to finance the necessary investment in government infrastructure, and in plant and equipment required to set up or grow private businesses. Countries need to escape the vicious cycle of poverty and low development. Breaking out of this circle is not easy, but the following strategies may help:

- Governments must set up and supervise well run and secure banks and financial institutions to collect whatever household savings there are.
- International capital inflow or foreign investment must be pursued, but with appropriate safeguards.
- International aid and gifts (private and government) need to be encouraged, as long as they do not have harsh conditions attached that hurt the local community.
- A system of microcredit needs to be created where small sums of money, perhaps as little as $100–200, are provided to those who want to start up a tiny business and who, otherwise, would not qualify for bank loans. This needs to be supplemented with some free basic business training.
- The government needs to ensure that the rich, in particular, pay the required taxes (on incomes and luxury goods) to help finance public investment and infrastructure projects.
- Government incentives (e.g. tax holidays) are needed to encourage private investment in projects that help promote national self-sufficiency in food and basic community services (i.e. social infrastructure).
- Measures (e.g. proper accounting and transparent record keeping, freedom of information and the press) are needed to help avoid wasting or misusing the government’s limited financial resources, adding to the burden of repaying debt.
- Exports (e.g. cash crops and basic manufactured items) from low-income countries need to be encouraged. This may be pursued through multilateral (perhaps through institutions like the World Trade Organization) or bilateral free trade agreements (between two countries) that are designed to reduce high levels of protection of primary industry, especially in Europe, Japan and the US. This would help to boost national income, saving and investment.

Provision of basic infrastructure

As we now know, having adequate infrastructure including education, health, power, water supply, transport, and law and order is an important key to growing the nation’s productive capacity, alleviating poverty and improving the quality of daily life. However, problems here are difficult to fix because of the scarcity of savings and lack of government
revenue. Various strategies were previously mentioned (see p. 328) as to how countries might raise the necessary investment capital.

**Managing debt levels**

*Debt* levels in poor countries are often high and represent well over 100 per cent of their GDP in some cases. This causes crippling interest repayments to rich nations. It often forces governments to reduce the level of government spending on community services and infrastructure. Debt needs to be cut to manageable levels, wasteful ‘white elephant’ projects that add little to welfare terminated, substantial military expenditures cut and governments held accountable for all spending. Even so, some countries need a hand getting their debt under control. The International Monetary Fund (IMF) has provided full or partial debt relief to 36 countries to January 2012. This provides a breather, but is not a permanent solution. Additionally, borrowed money needs to be used efficiently for projects that bring widespread improvements in the capacity of the economy to produce goods and services that encourage national self-sufficiency and independence.

**Reforming government and promoting democracy**

Poor countries badly need political democracy where the majority of voters in regular and free elections choose the government from a range of candidates representing different political parties. In addition, it is also vital that there is freedom of speech and freedom of the press (i.e. where the media can be critical of government policies). These things add to administrative transparency, help to hold governments accountable for their actions, and reduce incompetence, corruption and war.

A strong legal framework is also important in poorer countries to ensure that laws protect the rights of workers, make child labour illegal so children gain an education, guarantee civil rights including free speech, protect the environment and promote strong price competition in domestic markets. While change is desperately needed, making it happen peacefully is often difficult. This is because those with power usually want to hang on to it by using military force, repression and resisting reform.

**Reducing trade protection by rich countries**

Many rich nations protect their farmers, manufacturing firms and miners from competition by poorer countries that are trying to export primary commodities (e.g. coffee, rice, soy beans, maize and sugar) and basic manufactured products. Here, we think of the heavy protection of farmers in the US, Japan and the European Union by means of tariffs, subsidies and import quotas that were operated in past decades. We also think of the attempts by Australia and some developing countries through numerous rounds of multilateral trade negotiations to convince these rich countries of the need to expand free trade. Progress here has been slow. However, as table 8.2 (p. 330) shows, tariff protection on products imported from the ‘least’ developed Third World countries has come down during the 2000s.
TABLE 8.2 Changes in levels of tariff protection by selected developed countries on imports from the ‘least’ developed Third World countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage of imported goods from least developed countries that are admitted free of tariffs 2000/2007</th>
<th>Average tariff rate on agricultural imports from least developed countries 2000/2007</th>
<th>Average tariff rate on textile imports from least developed countries 2000/2007</th>
<th>Average tariff rate on clothing imports from least developed countries 2000/2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>94.5/100.0</td>
<td>0.2/0.0</td>
<td>5.0/0.0</td>
<td>19.6/0.0</td>
</tr>
<tr>
<td>Canada</td>
<td>48.3/99.9</td>
<td>0.3/0.1</td>
<td>5.8/0.2</td>
<td>18.8/1.7</td>
</tr>
<tr>
<td>Japan</td>
<td>82.2/99.6</td>
<td>4.9/1.3</td>
<td>0.2/2.6</td>
<td>0.0/0.1</td>
</tr>
<tr>
<td>Switzerland</td>
<td>93.3/95.0</td>
<td>6.0/2.8</td>
<td>0.0/0.0</td>
<td>0.0/0.0</td>
</tr>
<tr>
<td>US</td>
<td>46.2/76.8</td>
<td>6.3/6.0</td>
<td>6.8/5.6</td>
<td>13.9/11.3</td>
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</tbody>
</table>

Source: Data derived from the World Bank, 2010 World Development Indicators, table 1.4, p. 44.

Indeed, if all rich countries reduced protection, it would further boost export incomes of poor countries, thereby reducing their need to borrow money and run up a large foreign debt. It would also make essential imports of equipment, medicines and technology by low-income countries more affordable and lead to higher living standards.

Reducing income inequality

Income inequality is often much larger in poor countries (e.g. typically the Gini coefficient is between 0.5 and 0.7) than in rich nations (e.g. the Gini is less than 0.35). Frequently, inequality is reinforced by unequal ownership of land, official corruption, the absence of democracy, closed markets, state and private monopolies, special favours involving deals with the government, the caste system and the abuse of social, political and economic power. Democratically elected governments can best deal with economic inequality by introducing policies including:

- fairly progressive income taxes where rates (percentage of income paid in tax) rise with taxable income
- provision of free or cheap basic community services
- passing and enforcing trade practices acts to promote stronger competition in markets and check personal greed
- attacking corruption.

Reducing population pressures

Population in some low-income countries is growing quickly, at more than double the rate of high-income nations (some of which actually have declining populations). This places great strain on the government’s provision of infrastructure and services (e.g. transport, water, education, power, transport, law and health), and leads to unemployment, underemployment and idle resources.

The great burden created by population pressures can however be eased. Historical experience tells us that birth rates slow and families get smaller if there are improvements in general health (e.g. clean water supply and control of HIV/AIDS, malaria, measles and tuberculosis) and education standards, and by lowering the child mortality (death) rate. This is because, apart from common ignorance about family planning and health matters, to some extent, large families also reflect the uncertainties of infant survival and old age in countries where there is no government welfare system (e.g. unemployment benefits or old age pensions). Clearly, government spending to improve health and education must be given very high priority.
8.5 The role of government and private foreign aid to promote economic development

Foreign aid represents the transfer of funds and other types of assistance by governments and private individuals from high-income to lower-income countries. If used properly, international aid can be an important way of helping poor countries to improve their living standards. Most importantly, this assistance can help to break the vicious cycle of poverty, raise per capita incomes and improve the quality of daily life. Often it does this by raising the funds available for investment in social and economic infrastructure, lifting efficiency and accelerating productive capacity.

The three main forms of foreign aid

There are three main types of foreign aid — loans, grants and technical assistance. These are summarised below.

1. Loans. There are three kinds of loans — hard loans or credit offered at the normal market rate of interest; soft loans offered at a special discounted interest rate; and tied loans, where special conditions are imposed such as requiring that the money be used to purchase exports from the donor country. Of these, soft loans are probably the most beneficial for the recipient country. Official loans are also made by governments in donor countries like Australia. However, much is directed through multilateral institutions including the World Bank and the International Monetary Fund (see p. 298). Often the World Bank and IMF require that governments in countries receiving loans, make certain changes such as:
   • deregulating markets
   • strengthening efficiency
   • becoming more accountable in financial administration
   • ensuring that much of the money loaned is directed into social and economic infrastructure programs that meet the UN’s millennium development goals designed to improve the daily lives of ordinary people.

2. Grants are straight-out donations of cash that do not need to be repaid. When used wisely, this is perhaps the best type of help that high-income countries can offer. Normally grants are allocated by private international aid agencies (e.g. World Vision), or given by individual governments in donor countries. Often this type of aid is critical to provide immediate help after disasters such as famines, floods, earthquakes, wars or tsunamis.

3. Technical and other assistance. Technical and other assistance involves the donor country or a United Nations agency providing scientific, economic, educational, technical, industrial or agricultural personnel. These people advise on matters relating to economic development. On occasions, military-related assistance is given by individual donor countries.

   Figure 8.19 (p. 332) shows some of the countries that provide government foreign aid. The amount given is also expressed as a percentage of each country’s GDP. The latter measure gives a better idea as to a country’s generosity relative to the size of its economy. Although the US is easily the biggest donor, relative to GDP, Australia is nearly twice as generous. However, most donor nations, except Sweden and three others, fail to meet the 1970 agreed target of just 0.7 per cent of GDP. Table 8.3 (p. 333) looks at some of the main recipients of official or government foreign aid. While generally the level of overseas development aid reflects the needness of the recipient country, sometimes other considerations appear to have an impact such as strategic considerations and international political considerations.

The Australian government’s foreign aid

The Australian government’s foreign aid program (also called overseas development aid or ODA) seeks to reduce poverty in low-income countries and promote sustainable development that is in line with our national interests. It is distributed through AusAID. In 2013–14, our projected level of government aid is $5.7 billion or a projected 0.37 per cent of GDP.

   Figure 8.21 (p. 333) shows the countries which receive the largest share of our foreign aid include Indonesia, Papua New Guinea, the Solomon Islands, Vietnam, the Philippines, East Timor and Cambodia.
As shown in figure 8.22 (p. 334), Australia’s ODA typically goes to projects that improve education, water supply, transport, health, disaster relief, law and order, and other areas within the UN’s Millennium Development Goals. The lower section of figure 8.22 not only indicates some of the main priorities of our ODA for some of Australia’s largest recipients, but also shows the success or otherwise of recipient countries in achieving the 2015 Millennium Development Goals (MDGs). Note the achievements, for instance, in reducing poverty and hunger, and improved child and maternal health, but the lack of success for universal education, combating HIV/AIDS and environmental sustainability.
**TABLE 8.3** Selected countries that receive government development aid (US$ millions)

<table>
<thead>
<tr>
<th>Country</th>
<th>Value of net official development assistance or aid received (US$ millions)</th>
</tr>
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<tbody>
<tr>
<td>Afghanistan</td>
<td>6725</td>
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<tr>
<td>Vietnam</td>
<td>4115</td>
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<tr>
<td>Ethiopia</td>
<td>3261</td>
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<tr>
<td>Turkey</td>
<td>3033</td>
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<tr>
<td>Congo Democratic Republic</td>
<td>2859</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>2152</td>
</tr>
<tr>
<td>Mozambique</td>
<td>2096</td>
</tr>
<tr>
<td>Pakistan</td>
<td>2019</td>
</tr>
<tr>
<td>Nigeria</td>
<td>1915</td>
</tr>
<tr>
<td>Egypt</td>
<td>1806</td>
</tr>
<tr>
<td>India</td>
<td>1667</td>
</tr>
</tbody>
</table>

*Source: Data derived from The World Bank, data.worldbank.org/indicator/DT.ODA.ODAT.CD*

Some key destinations of Australian government overseas development assistance (ODA) or aid, 2013–14 (out of a total of A$5.7 billion in 2013–14)

- Indonesia, 646.8
- Papua New Guinea (PNG), 507
- Solomon Islands, 188
- Tonga, 32
- Fiji, 58
- Vanuatu, 65
- Kiribati, 29.7
- Samoa, 46
- Bangladesh, 111.4
- Sri Lanka, 48.5
- Afghanistan, 180.4
- Pakistan, 87.9
- Palestine Territories, 60.6
- Timor-Leste, 125.7
- Cambodia, 97.2
- Vietnam, 159.1
- Philippines, 141
- Laos, 62.4

*Source: Data used to construct the graph was derived from ‘Budget: Australia’s International Development Assistance Program, 2013–14, p. 12–, Statement by Bob Carr, Minister for Foreign Affairs (14 May 2013).*
Six strategic priorities of the Australian government’s overseas development aid (% of total aid)

- **Saving lives** — improving public health by access to safe water and sanitation, maternal and health services, disease prevention, vaccination and treatment = 19%
- **Effective governance** — improving the capacity and efficiency of government organisations to deliver services and to enhance justice and human rights = 16%
- **General development support of UN programs** = 7%
- **Sustainable economic development** — improving employment, incomes, enterprise opportunities, food security, economic development and climate change = 19%
- **Promoting opportunities for all** — promoting education, empowering women in the economy, business and leadership = 22%
- **Humanitarian and disaster response** — helping to improve preparedness and response to disasters and crises = 17%

**Summary of aims for aid granted to the following countries:**

- **Indonesia** ($558.1m): to strengthen democratic mechanisms and systems of justice, promote sustainable GDP growth, improve macroeconomic management, better delivery of community services, promote good governance and enhance peace and safety.
- **Papua New Guinea** ($482.3m): to accelerate progress towards basic education for all people, upgrade health outcomes, build up the public service, improve governance, and provide better access for firms to domestic and international markets.
- **Solomon Islands** ($261.6m): to improve the efficiency of economic infrastructure, upgrade the delivery services to communities, strengthen economic security for people, address economic challenges to help raise living standards, and strengthen the functioning of government.
- **East Timor** ($123.7m): to undertake projects that improve health services and outcomes, improve support for the expansion of rural employment and jobs, strengthen public financial management and enhance internal security.

**Progress towards the MDGs**

<table>
<thead>
<tr>
<th>MDG 1</th>
<th>MDG 2</th>
<th>MDG 3</th>
<th>MDG 4</th>
<th>MDG 5</th>
<th>MDG 6</th>
<th>MDG 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>End Poverty and Hunger</td>
<td>Universal Education</td>
<td>Gender Equality</td>
<td>Child Health</td>
<td>Maternal Health</td>
<td>Combat HIV/AIDS</td>
<td>Environmental Sustainability</td>
</tr>
<tr>
<td>✓</td>
<td>✗</td>
<td>−</td>
<td>✓</td>
<td>✓</td>
<td>✗</td>
<td>✗</td>
</tr>
</tbody>
</table>

Progress towards the 2015 MDG targets (see Diagram 1 for more detail) is indicated by a tick (already achieved or on-track), a cross (slow, regressing or no progress), or a dash (insufficient data to assess).

**FIGURE 8.22** Key priorities for Australian overseas development aid (ODA), 2013–14


In addition to Australian government aid, there is also substantial private aid that is distributed through international agencies like the Red Cross, World Vision and Oxfam.
8.6 Current issues facing a developing nation in Asia — Vietnam, a case study

The Socialist Republic of Vietnam is a rapidly developing economy in the South Asian region. To fully understand the issues facing Vietnam it may be useful to gain some background information about Vietnam’s history.

Background history
The country’s turbulent history goes back at least to 111 BC. Dynasties (rulers from the same family that have held power for generations) ruled Vietnam and in the early 1400s the Chinese occupied Vietnam. There was political instability, and a period of French colonial rule from 1867 to 1954. The Vietnamese, under the communist leader Ho Chi Minh, were successful in driving out the French in 1954. At this time the country was divided into the communist north (with a planned socialist economy) and capitalist south. The Vietnam War occurred between 1964 and 1973. Finally in 1976 there was the re-unification of the north and south and the current Socialist Republic of Vietnam was set up.

Initially, between 1976 and 1986, the Vietnamese economy was run as a planned socialist economy (similar to the model used in China between 1949 and the early 1980s). Decision making was controlled through comprehensive and detailed government five-year economic plans (as opposed to decisions made through the price or market system). Here, instructions about what, how much and how to produce were passed down the command chain from the top. Prices were regulated by the state and many areas were subsidised by the government. The ideal of creating a fairly even socialist distribution of income was pursued through government wage determination. In addition, most of the means of production — the farms, mines, banks, factories, major stores and services were owned and run by the state, and local communes. However, by 1986, there was growing disappointment with the economy’s performance and the failure of comprehensive and rigid government planning. The time was right for change.

Economic reforms 1986–2014
In 1986, an economic reform program for the economy was commenced. It was called ‘Doi moi’ and it signalled the shift from central planning to a more deregulated, socialist-oriented, market economy. Largely as a result, Vietnam’s rate of economic growth accelerated. There were many areas of change. These included passing laws that recognised private ownership of property, putting a halt to the nationalisation of enterprises in the southern area, implementing agricultural and land reforms to allow private farming and end agricultural collectives, setting up the necessary institutions for the freer operation of various markets (e.g. the capital market including the stock exchange, labour market, resource markets), progressively abolishing price controls, opening the nation’s borders to foreign investment and trade, and moving towards integration in the global economy by membership of international organisations (e.g. the World Trade Organization, International Monetary Fund, ASEAN, World Bank, and even a free trade agreement with the US).

While there is still economic planning by the government today, it does not follow the rigid, comprehensive
model of the past. Indeed, the last completed five-year indicative plan covers the period 2011–15. It set out broad guidelines for continued social and economic development, along the lines of a socialist-oriented, market economy. It emphasises ongoing structural change from a rural economy to an industrialised modern system by 2020.

Some highlights of recent economic development

Due to war and many other obstacles limiting economic development until recently, there were high poverty rates and fairly miserable daily living conditions. However, starting in 1986, there has been remarkable economic, social and political progress in Vietnam, affecting the lives of 91 million people:

- Average annual level of per capita income or GDP (after allowing for inflation) increased nearly sevenfold between 1990 and 2012, from US$200 to over US$1600. This represents an average rise of almost 6 per cent a year in purchasing power and is a major reason for the reduction in poverty and improved life expectancy.
- The growth rate in household consumption more than quadrupled between 1987 and 2012, dramatically lifting general living standards.
- With rising incomes and consumption, overall poverty rates have fallen to 17.2 per cent (with 22.1 per cent in rural areas and 5.4 per cent in urban areas). Average life expectancy at birth is now over 73 years and the adult literacy rate is around 94 per cent (with about 90 per cent of children attending primary school).
- Sustained and rapid economic growth was the main reason for improved living conditions (although there was a setback during the GFC in 2009). As partly reflected in figure 8.25 below, Vietnam’s GDP has risen by an average of around 6.5 per cent a year for the past 10 years. At this rate, production has far outstripped population growth (which has slowed to around 1 per cent due to reduced infant mortality, better education and improved health). Based on recent trends, many of the United Nation’s millennium development goals will be achieved in Vietnam by 2015.

There has been a fast rate of growth in domestic (i.e. government, private) and foreign investment spending (averaging well over 10 per cent a year) on physical plant, equipment, and social and economic infrastructure (e.g. treated water supply, electricity, transport, health, schools and universities, legal institutions, sewerage). This has accelerated the growth in output per hour worked, expanded the nation’s production possibility frontier and, most importantly, improved people’s daily lives.

- Thanks to strong investment and economic growth in most recent years to 2013, unemployment rates have been very low, averaging less than 2.0 per cent of the labour force. This has meant that there is less unused productive capacity, higher incomes and reduced poverty.
- There has been massive structural change in the economy. Resources have shifted from a traditional rural subsistence economy, to one that is more modern, urbanised, industrialised and internationalised. For instance, in 1987, agriculture contributed nearly 41 per cent of GDP, but by 2013 this had fallen to around 19 per cent. On the other hand, during the same period, manufacturing industry rose from 28 to 42 per cent of GDP by value. There was also a substantial growth of services and exports, as is typical of more developed economies.
Current issues facing Vietnam as a developing economy

Rapid economic development in Vietnam has brought both costs and benefits. Some of the key issues are listed below.

• **Increased inflation.** Although it is not unexpected, inflationary pressures are common in economies that grow quickly. Often this is because aggregate demand or spending outstrips productive capacity or aggregate supply, creating shortages of goods and services. In the ten years to 2014, annual inflation averaged over 11 per cent (due to especially high rates in 2009, 2010 and 2011).

• **Globalisation and the impact of the recent global recession.** Globalisation and integration into the world economy has meant a growing dependence on export income. Indeed, Vietnam now has seven free trade agreements, most as a partner within ASEAN. When the global financial crisis and recession of late 2008 and 2009 depressed confidence around the world, this caused Vietnam’s exports to fall, in turn jeopardising employment and economic growth, undermining government poverty reduction schemes, and depressing living conditions. However, more recently, the economy bounced back quite strongly with trade surpluses recorded for 2012 and 2013.

• **Income inequality and redistribution.** A large part of Vietnam’s economic growth and development has been centred in the more populated and industrialised cities. Some subsistence rural regions and ethnic minority groups (e.g. people in the northern-western mountains) have been bypassed by economic development, so there is rising inequality in incomes (Vietnam’s Gini coefficient is 0.36) and living standards.

• **Infrastructure pressures including energy.** Strong economic growth and improved quality of life require good access to social and economic infrastructure (e.g. electricity, roads, ports, schools, hospitals, water supply). Although Vietnam’s population is not rising quickly, higher living standards and business expansion have led to infrastructure shortages or bottlenecks. In addition, these are expensive projects, necessitating government borrowing internationally. Despite receiving substantial international aid (some from Australia), this has also caused the foreign debt and interest repayments to be quite high.

• **Corruption.** In many parts of the world, including Vietnam, entrenched corruption at all levels is a problem. It undermines economic efficiency, causes inequality and erodes business confidence. Unfortunately, international corruption statistics rank the country 123 out of 174, placing it in the worst 30 per cent of nations.

• **Aging population.** With the slowdown in the birth rate to a mere 0.7 per cent a year, combined with reduced poverty, improved health and increased life expectancy, it is not surprising that Vietnam’s population is ageing. This is creating problems, including increased dependence rates by the aged and growing demands on the health system. Normally, ageing of the population would also lead to shrinkage of the labour force. However, the drift of workers from the countryside to the city in search of better pay and jobs is currently checking the problem.

• **The environment.** As in most developing countries, economic growth in Vietnam has resulted in environmental costs or negative externalities, particularly in urban areas. This is due to overcrowding and increased industrial discharges into the rivers, soils and air. For example, currently only around 50 per cent of factories satisfy good environmental standards and CO₂ emissions have increased by 325 per cent between 1993 and 2013.

• **How to better achieve the UN’s Millennium Development Goals.** While Vietnam has made great strides towards achieving some of the United Nation’s Millennium Development Goals (particularly in raising average incomes, reducing poverty, improving literacy, creating opportunities for women and children, and lifting health), there are other areas where this will prove difficult (child malnutrition, infant mortality, pollution emissions, gender equality and income inequality).

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**Check Your Understanding**

1. Identify and outline the key government economic reforms that have helped to promote economic development in Vietnam.

2. List and outline six major economic problems faced by the Vietnamese economy as it seeks to promote economic development and improve living standards.

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• Try applied economic exercise 6, p. 342
• Try a case study — involving a virtual developing economy, Zambia, p. 343
• Try the multiple-choice test, pp. 338-9
• Try an essay, p. 342
• Try a folio of annotated media commentaries using print or electronic materials, p. 343
• Try analysis of visual evidence — watching a DVD, p. 343
SCHOOL ASSESSMENT TASKS AND LEARNING ACTIVITIES

In order to satisfactorily complete VCE Economics Unit 2, Outcome 2, the teacher must decide whether the student has demonstrated the general achievement of the set of outcomes specified for the unit, including key knowledge and key skills for Outcome 2. The teacher's decision should reflect results from a selection of school-based assessment tasks. Generally, this assessment should take place as part of the normal teaching and learning program. In addition, most assessment will be completed in class under a limited time frame. With this in mind, teachers may select from an appropriate range of tasks provided on the following pages.

Multiple-choice test questions

Using the multiple-choice answer grid, select the letter (A, B, C, D) that represents the most appropriate answer for each question, by marking it with a tick (✓).

**Answer grid**

<table>
<thead>
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<th>Question</th>
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**Question 1**
Which of the following measures best indicates the level of material living standards?
A GDP  
B GDP per capita  
C GDP per capita adjusted for purchasing power parity (PPP)  
D Total national income

**Question 2**
Which of the following developing countries would currently have the lowest per capita income?
A China  
B Fiji  
C Vietnam  
D Brazil

**Question 3**
All of the following would tend to cause a nation's productive capacity to grow, except:
A discovery of new mineral deposits.  
B increased household consumption spending and reduced rates of national saving and investment.  
C use of genetically modified crops in agriculture.  
D government provision of improved infrastructure, including water and power supply.

**Question 4**
The concept of labour efficiency or productivity is best defined as:
A the level of production or GDP per year.  
B the rate of economic growth between one year and the next.  
C the value of GDP divided by the total number of hours worked.  
D the value of GDP divided by the size of the population.

**Question 5**
Agricultural productivity in low-income countries is usually very weak due to:
A the lack of access to technology and fertiliser, and the use of traditional methods of production.  
B overcrowding, the diminished size of farms and the shift onto less fertile agricultural soils.  
C widespread underemployment of labour.  
D All of the above are common.

**Question 6**
Most low-income countries are characterised by:
A the vicious cycle of poverty.  
B the lack of savings and proper financial institutions.  
C high interest rates, low investment and the absence of widespread business expansion.  
D All of the above slow economic development.

**Question 7**
Regarding economic growth and development in a low-income country, which of the following is incorrect?
A Economic development concerns improvements in general living standards and the quality of daily life.  
B Economic development is only concerned with rises in material living standards.  
C Economic development may be helped by economic growth, if output grows faster than the total population.  
D Economic development often used to be seen as the same thing as economic growth, until the late 1970s and early 1980s when the concept was broadened.

**Question 8**
Which of the following would be least likely to accelerate economic development in a low-income country?
A Allowing free speech and democracy.  
B Using foreign borrowing to finance consumption and military spending.  
C Increased spending on lifting literacy and education standards.  
D Measures to improve health (including sanitation, vaccination programs and water supply), reduce infant mortality rates, and improve welfare benefits for the aged.

**Question 9**
Most low-income countries have large balance of payments current account deficits. Which of the following generally offers the weakest explanation of this problem?
A Often rich countries in Europe, Japan and the United States protect their farmers and firms, thus limiting export volumes from low-income countries.  
B Widespread subsistence farming in many of these countries reduces export volumes.  
C There are usually heavy interest repayments by low-income countries on their large foreign debts.  
D Imports of defence equipment by dictatorships are easily the main reason for the deficit.

**Question 10**
Which statement about foreign debt in low-income countries is incorrect?
A All foreign debt is bad and slows economic development through income repayment abroad to rich nations.  
B Debt that is used for social and economic infrastructure can help to improve the quality of daily life of ordinary people, partly by growing the nation's productive capacity.  
C The concept of debt was broadened.  
D Economic development often used to be seen as the same thing as economic growth, until the late 1970s and early 1980s when the concept was broadened.
C For some countries, the value of the foreign debt is equal to more than 100 per cent of the value of GDP.
D All of the above.

**Question 11**
Rapid population growth is often a serious problem in low-income countries because:
A overpopulation puts pressure on the nation’s limited natural resources, depresses rural productivity and worsens environmental damage.
B it causes many problems associated with accelerated rates of urban growth.
C it diminishes the quality of social and economic infrastructure and worsens the government’s financial problems.
D All of the above.

**Question 12**
Which statement about international aid is incorrect?
A Being a socialist country, there has been a switch from a market to a fully or comprehensively government planned economy, like that in China.
B Population growth is very rapid by comparison with Australia or high-income economies.
C There has been general acceptance of trade liberalisation and integration into the global economy.
D All of the above.

**Question 13**
International and Australian foreign aid is mostly used to promote development in line with the United Nation’s Millennium Development Goals. Which statement about international aid is false?
A Australia donates a higher percentage of its GDP in foreign aid, than do the US or Japan.
B Hard loans to low-income countries are those where the receiving country is given a favourable, discounted or lower interest rate than that normally prevailing in the market.
C Debt repayments by low-income countries mean that governments often reduce outlays on education and health.
D The achievement of the UN’s Millennium Development Goals involve improving a broad range of aspects affecting the quality of daily life for people living in low-income countries by 2015, indicated by around 60 statistical measures.

**Question 14**
Increasing investment levels is vital for economic development. Which statement about the role of investment in low-income countries is incorrect?
A High levels of investment grow labour productivity and per capita incomes.
B High levels of investment in social infrastructure improve the daily wellbeing of people, and grow productivity and per capita incomes.
C High levels of investment in the long term will cause even higher unemployment by replacing labour with physical capital, equipment and machines.
D High levels of investment help to break the vicious cycle of poverty and low income.

**Terminology revision**
Below is a list of some of the main economic terms used in chapter 8. Briefly and accurately write out definitions for each of these terms. Alternatively, an interesting way to revise terminology is to construct your own crossword. Use the Economics dictionary in your text to write the clues and refer to table 8.4 for the terminology.

**Applied economic exercises**

**Question 1**
A Define what is meant by low-income countries. What are some of the general consequences or indicators of being a low-income country?
B ‘Economic development is more than accelerating the rate of economic growth’. Explain what this statement means.

**Question 2**
A Explain how each of the following can be used to measure the level of economic development in low-income countries, noting the main weakness of each:
(i) annual average GDP per capita
(ii) human development index (HDI)
(iii) indicators for the Millennium Development Goals (MDG).
B Use the information in table 8.5 below to calculate GDP per capita for Australia and Vietnam.

**Table 8.4**

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>debt repayments/servicing</td>
<td>Infrastructure (social and economic)</td>
</tr>
<tr>
<td>economic development</td>
<td>International Monetary Fund (IMF) protection</td>
</tr>
<tr>
<td>economic growth</td>
<td>low-income countries savings</td>
</tr>
<tr>
<td>foreign or international aid</td>
<td>microcredit subsidies</td>
</tr>
<tr>
<td>Gini coefficient for income distribution</td>
<td>Millennium Development Goals (MDG) tariffs</td>
</tr>
<tr>
<td>globalisation</td>
<td>overseas debt vicious cycle of poverty</td>
</tr>
<tr>
<td>high-income countries</td>
<td>per capita GDP World Bank</td>
</tr>
<tr>
<td>human development index (HDI)</td>
<td>poverty</td>
</tr>
<tr>
<td>investment</td>
<td>production possibility frontier (PPF)</td>
</tr>
</tbody>
</table>

**Table 8.5**

<table>
<thead>
<tr>
<th>Data</th>
<th>Australia (US$ millions)</th>
<th>Vietnam (US$ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of GDP (nominal)</td>
<td>1 515 468</td>
<td>138 100</td>
</tr>
<tr>
<td>Population size (millions)</td>
<td>23.1</td>
<td>90.4</td>
</tr>
<tr>
<td>Average GDP per capita per year (US$)</td>
<td>$ ................... $ ...................</td>
<td></td>
</tr>
</tbody>
</table>

Sources: Data derived from International Monetary Fund and World Bank. Note: Data are for 2013.

C Carefully examine table 8.6 (p. 340), which contains seven possible indicators for the level of economic development in selected countries.

(i) Your task is to try to calculate your own composite (i.e. single) index measuring the level of economic development, using any four of these seven indicators. Show your calculations and justify your choice of measure. It is up to you whether you score or measure your index out of 400, 100, 10 or any other number of index points, and whether you weigh some items or indicators in this index more heavily than others because you feel they have a larger influence on the level of economic development.

(ii) Using your calculated index, rank the six countries from the highest to the lowest level of economic development.
One requirement for economic development is to grow this capacity. Low-income countries have limited productive capacity.

**Question 3**

You might also like to check out a similar activity using the United Nation’s Human Development Report to construct or build your own HDI — see hdr.undp.org/en/data/build. You might also like to check out a similar activity using the

**Question 4**

Examine the data relating to the productive capacity or production possibilities for a hypothetical low-income country in northern Africa, called the Republic of Saradonia. This small country is primarily an agricultural economy, but it is starting to grow its manufacturing industry. Assume therefore, that the country can choose to produce either manufactured goods or agricultural goods. This and other information is shown in table 8.7 below. Notice that there are two parts to the table, one containing data for 2015 and the other containing data for 2020. Each table has numbered lines, 1–5.

**TABLE 8.7** Production possibilities for the hypothetical country of Saradonia, a low-income developing economy

<table>
<thead>
<tr>
<th>Information for Saradonia, 2015</th>
<th>Production possibility A</th>
<th>Production possibility B</th>
<th>Production possibility C</th>
<th>Production possibility D</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Annual production of manufactured goods in 2015 (US$ millions)</td>
<td>250</td>
<td>200</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>2. Annual production of agricultural goods in 2015 (US$ millions)</td>
<td>0</td>
<td>350</td>
<td>550</td>
<td>600</td>
</tr>
<tr>
<td>3. Calculate the potential total level of GDP in 2015 at different production possibilities (US$ millions) =</td>
<td>..........</td>
<td>..........</td>
<td>..........</td>
<td>..........</td>
</tr>
<tr>
<td>4. Population size (millions) in 2015 =</td>
<td>1.2 million</td>
<td>1.2 million</td>
<td>1.2 million</td>
<td>1.2 million</td>
</tr>
<tr>
<td>5. Calculate the annual average level of GDP per capita in 2015 at different production possibilities (US$) =</td>
<td>..........</td>
<td>..........</td>
<td>..........</td>
<td>..........</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Information for Saradonia, 2020</th>
<th>Production possibility A</th>
<th>Production possibility B</th>
<th>Production possibility C</th>
<th>Production possibility D</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Annual production of manufactured goods in 2020 (US$ millions)</td>
<td>350</td>
<td>250</td>
<td>150</td>
<td>0</td>
</tr>
<tr>
<td>2. Annual production of agricultural goods in 2020 (US$ millions)</td>
<td>0</td>
<td>400</td>
<td>650</td>
<td>750</td>
</tr>
<tr>
<td>3. Calculate the potential total level of GDP in 2020 at different production possibilities (US$ millions) =</td>
<td>..........</td>
<td>..........</td>
<td>..........</td>
<td>..........</td>
</tr>
<tr>
<td>4. Population size (millions) in 2020 =</td>
<td>1.3 million</td>
<td>1.3 million</td>
<td>1.3 million</td>
<td>1.3 million</td>
</tr>
<tr>
<td>5. Calculate the annual average level of GDP per capita in 2020 at different production possibilities (US$) =</td>
<td>..........</td>
<td>..........</td>
<td>..........</td>
<td>..........</td>
</tr>
</tbody>
</table>
A To what extent have world poverty rates (defined here at US$1 per day) been reduced between 1981 and 2005, leaving China in the statistics?

B By comparison, if China is removed from the data (see graph 2, figure 8.27 below), to what extent have global poverty rates been reduced?

C List and briefly outline four important policies that would help reduce global poverty.

**Graph 1 — Poverty levels over time — percentage of world population**

![Graph 1](image)

**Graph 2 — Poverty levels over time excluding China — percentage of world population**

![Graph 2](image)

**Question 5**

Examine figure 8.27 showing trends in global poverty rates, before answering the questions that follow.
Question 6
A What are the main types of foreign aid and what are its main aims?
B Which type of aid is probably most beneficial to a low-income country? Explain.
C ‘Australia is not as generous as the US when it comes to foreign aid.’ Discuss this opinion using statistical evidence drawn from your text and elsewhere.
D Identify and explain two important problems associated with foreign aid in low-income countries.
E Examine table 8.8 below containing estimates for some non-essential spending by the world, as against the cost of overcoming problems that lead to poverty in low-income countries. Use the data in the table to calculate the percentage of the world’s annual military spending that would be required to overcome some of the key problems that lead to poverty in low-income countries.

TABLE 8.8 Estimates of spending on non-necessities and the outlays required to help alleviate global poverty

<table>
<thead>
<tr>
<th>Areas of global spending on non-necessities</th>
<th>US$ billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Cosmetics purchased in the United States</td>
<td>8</td>
</tr>
<tr>
<td>2. Spending on ice-cream in Europe</td>
<td>11</td>
</tr>
<tr>
<td>3. Consumption of perfumes in Europe and the United States</td>
<td>12</td>
</tr>
<tr>
<td>4. Purchases of pet food in Europe and the United States</td>
<td>17</td>
</tr>
<tr>
<td>5. Business entertainment in Japan</td>
<td>35</td>
</tr>
<tr>
<td>6. Spending on cigarettes in Europe</td>
<td>50</td>
</tr>
<tr>
<td>7. Alcoholic drinks in Europe</td>
<td>105</td>
</tr>
<tr>
<td>8. Global consumption of narcotic drugs</td>
<td>400</td>
</tr>
<tr>
<td>9. Global military spending</td>
<td>780</td>
</tr>
<tr>
<td>TOTAL</td>
<td>1418</td>
</tr>
</tbody>
</table>

The cost of improving some aspects of daily life for those in low-income countries

<table>
<thead>
<tr>
<th>US$ billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Primary education for all</td>
</tr>
<tr>
<td>2. Access to clean water and sanitation for all</td>
</tr>
<tr>
<td>3. Improve women’s health</td>
</tr>
<tr>
<td>4. Basic nutrition and health</td>
</tr>
<tr>
<td>TOTAL</td>
</tr>
</tbody>
</table>

Source: Data derived from Global Issues website. Estimates are based on World Bank figures from 1998.

Question 7
Vietnam is a successful developing economy that has adopted a socialist-oriented, market type of economic system.
A What is meant by a socialist system?
B What role does the market play in this economy? What is the alternative system?
C What are three important developments that have helped to accelerate the rate of economic growth in Vietnam?
D Examine figure 8.28 below.

When the pace of Vietnam’s economic development accelerated (annual economic growth averaged nearly 7 percent) and the economy approached its PPF where unemployment was low, why is it not surprising that the inflation rate also increased, as shown in 2007–08 (or indeed inflation averaged a high 10.7 per cent between 2003–04 and 2013–14).

E In Vietnam, there has been a drift away from agricultural production towards manufacturing. Outline one cost and one benefit of this structural change.

F How might the growth in the value of Vietnam’s exports help the country’s economic development?

G In Vietnam, there has been a rapid growth in the level of government, and especially private, investment spending. Foreign direct investment rose to average around US$10–11 billion per year between 2011 and 2014.

(a) Explain why high levels of investment are vital for accelerating the rate of economic development.
(b) Identify and explain one possible economic problem associated with the rise in foreign investment in Vietnam.

An essay
Write a 400-word essay that answers the following question. Identify and explain what you feel are the four main causes of poverty and low living standards in most Third World nations. For each problem, explain two key policy changes that are needed to help overcome these obstacles to economic development. Where possible, illustrate your answer by reference to particular countries.

A class debate
After dividing into two teams (one for the affirmative and one for the negative), work with others to prepare a debate about one of the following topics:
1. It is immoral that the richest 20 per cent of the world’s population consumes 80 per cent of the world’s resources.

An essay

Write a 400-word essay that answers the following question. Identify and explain what you feel are the four main causes of poverty and low living standards in most Third World nations. For each problem, explain two key policy changes that are needed to help overcome these obstacles to economic development. Where possible, illustrate your answer by reference to particular countries.

A class debate

After dividing into two teams (one for the affirmative and one for the negative), work with others to prepare a debate about one of the following topics:
1. It is immoral that the richest 20 per cent of the world’s population consumes 80 per cent of the world’s resources.
2. The best way to improve living standards in low-income countries is to provide free contraceptives and enforce a policy involving a one-child family, as used in China.
3. A colonial past has caused many poor countries to be even poorer.
4. Economic development should seek to promote industrialisation.
5. The main thing for economic development is to maximise the country’s rate of economic growth.
6. Western nations need to spread democracy as a solution to poverty in Third World nations.
8. Rich nations need to show leadership and morality by quarantining the percentage of their GDP provided in foreign aid or assistance.
9. International aid creates more problems than it solves for low-income countries.
10. Debt cancellation by rich nations helps low-income countries to accelerate economic development.

A folio of annotated media commentaries using print or electronic materials

Carefully select four newspaper articles for a media folio about development economics as a global issue. For instance, these media commentaries may report:
- Economic conditions and developments in low-income or Third World nations
- Government policies that have affected economic development in a low-income or Third World country
- Issues related to international aid programs (government and private sources) and disaster relief efforts to help low-income or Third World countries
- International discussions by the WTO and other organisations related to reducing agricultural tariffs and farm subsidies by high-income countries in Europe, as well as in Japan and the US
- The effect of global economic conditions on low-income or Third World countries
- Poverty reduction policies in low-income or Third World countries
- Developments in the pursuit of the UN’s Millennium Development Goals.

Annotate these articles. Identify, explain and discuss the major ideas raised in the media article. These extracts could come from various sources including print (i.e. newspapers and magazines) or the internet. Be sure to clearly indicate or footnote the source of this information.

Analysis of visual evidence — watching a DVD

There are a number of interesting DVDs and programs covering the topic of development economics. Try viewing the following:
1. The web movie ‘If the Earth was 100 people’
2. Foreign Correspondent ‘Ethiopia famine’ (ABC) by reporter, Chris Clarke
3. ‘Population and World Resources’ (Classroom Video)
4. The cutting edge — empty oceans, empty nets (SBS, 10 June 2003)
5. Future of food (SBS 1, 8 February 2011)
7. The growing anger of hunger (SBS, 28 April 2009)
8. Aftermath, population overload (National Geographic, 12 March 2011)
9. Amazon (various programs, SBS, 19 October 2011)
10. Food for all (New Atlantis, 2007)
11. Why poverty, stealing Africa (ABC 2, 28 November 2012)
13. Australia’s aid — rising hope (Channel 10, 28 July 2013)
14. Kevin McLeod (several parts, ABC 1, 26 October 2010)
15. Slum survivors (IRIN, 2008)
16. The problem of Third World debt (Blip TV, 2009)
17. Vietnam — impact of aid and development (Classroom Video)
18. Welcome to India (various programs, SBS 1, 2013)
19. Welcome to Lesos (various programs, SBS 1, 2010)
Analysis of visual evidence — using written and statistical evidence about global social and economic conditions

Read the following extract ‘If the world were a village of 1000 people’. This condenses the population of the world down to 1000 people (not the over 7 billion we now have).

A What is the most common nationality?
B How would expenditure on defence compare with spending on health or education?
C What are the most serious causes of death?

If the world were a village of 1000 people

By DONELLA MEADOWS

If the world were a village of 1000 people, it would include:

- 584 Asians
- 124 Africans
- 95 East and West Europeans
- 84 Latin Americans
- 55 Soviets (including for the moment Lithuanians, Latvians, Estonians and other national groups)
- 52 North Americans
- 6 Australians and New Zealanders.

The people of the village have considerable difficulty in communicating

- 165 people speak Mandarin
- 86 English
- 83 Hindi/Urdu
- 64 Spanish
- 58 Russian
- 37 Arabic.

That list accounts for the mother tongues of only half the villagers. The other half speak (in descending order of frequency) Bengali, Portuguese, Indonesian, Japanese, German, French and 200 other languages.

In this village of 1000 there are

- 329 Christians (among them 187 Catholics, 84 Protestants, 31 Orthodox)
- 178 Moslems
- 167 ‘non-religious’
- 132 Hindus
- 60 Buddhists
- 45 atheists
- 3 Jews
- 86 people of all other religions.

One-third (330) of the 1000 people in the world village are children and only 60 are over the age of 65. Half the children are immunised against preventable infectious diseases such as measles and polio.

Just under half of the married women in the village have access to and use modern contraceptives.

This year, 28 babies will be born. Ten people will die, 3 of them for lack of food, 1 from cancer, 2 of the deaths are of babies born within the year. One person of the 1000 is infected with the HIV virus; that person most likely has not yet developed a fullblown case of AIDS.

With the 28 births and 10 deaths, the population of the village next year will be 1018.

In this 1000-person community, 200 people receive 75 per cent of the income; another 200 receive only 2 per cent of the income.

Only 70 people of the 1000 own an automobile (although some of the 70 own more than one automobile).

About one-third have access to clean, safe drinking water.

Of the 670 adults in the village, half are illiterate.

The village has six acres of land per person, 6000 acres in all, of which

- 700 acres are cropland
- 1400 acres pasture
- 1900 acres woodland
- 2000 acres desert, tundra, pavement and other wasteland
- The woodland is declining rapidly; the wasteland is increasing. The other land categories are roughly stable.

The village allocates 83 per cent of its fertiliser to 40 per cent of its cropland —
that owned by the richest and best fed 270 people. Excess fertiliser running off this land causes pollution in lakes and wells. The remaining 60 per cent of the land, with its 17 per cent of the fertiliser, produces 28 per cent of the food grains and feeds 73 per cent of the people. The average grain yield on that land is one-third the harvest achieved by the richer villagers.

**In the village of 1000 people, there are**
- 5 soldiers
- 7 teachers
- 1 doctor

**3 refugees driven from home by war or drought. The village has a total budget each year, public and private, of over $3 million — $3000 per person if it is distributed evenly (which, as we have already seen, it isn’t).**

**Of the total $3 million**
- $181 000 goes to weapons and warfare
- $159 000 for education
- $132 000 for health care.

The village has buried beneath it enough explosive power in nuclear weapons to blow itself to smithereens many times over.

**Analysis of written evidence — using an article about microcredit**

There is much poverty around the world, and income inequality between countries is huge. Sometimes people in rich countries would like to help but do not know where to start. They often feel powerless. However, each of us could make a difference. It is not always a matter of giving large ‘handouts’ to those in poor countries, but rather, a matter of providing them with a ‘helping hand’ so that they can become economically self-sufficient and permanently independent. Years ago an Australian, David Bussau, had the idea of using microcredit to make a difference. It involves providing individuals and groups (often women) with a small amount of money capital to start up a business (perhaps made possible by the purchase of a sewing machine to manufacture clothes, an oven to prepare food, or basic tools for farming). This could involve lending as little as $100–200. In addition, interest rates on these loans are low and repayment times are very flexible to help improve the opportunities for business success. A strength of this scheme is that the original money can be used over and over again to help start up new income-generating activities. Normally, these people would not be able to borrow credit from banks, because they are considered a bad risk. Alternatively, those wanting to go into business were at the mercy of ‘loan sharks’, who charged huge interest rates and were harsh on people who defaulted on repayments. Once started, a small business can earn income, grow household savings, create jobs for others and reduce poverty in local communities. Indeed, according to the World Bank, these projects may eradicate 10 per cent of the world’s poverty by 2020. As recognition of the importance of the idea, the United Nations declared 2005 as the International Year of Microcredit.

Armed with this background information, read the newspaper article ‘For aid, just help yourself’ before answering the questions that follow.

A What types of international development aid were provided by the Australian government in 2013–14? About how much money did this involve that year?

B How many people internationally benefit each year from microcredit according to the article?

C The article says that microcredit involves ‘small, collateral-free loans and other financial services . . . ? What do you think this means and how is the money used?

D Using Bangladesh as a case study, how successful has the use of microcredit been?

E Name some international organisations providing microcredit.

F What is the main United Nations ‘Millennium Development Goal’?

G What changes are needed to Australia’s foreign aid program, according to RESULTS Australia?

---

For aid, just help yourself

Shunned by traditional lenders, people in the Third World can now get low collateral loans to help them improve their lives. The results are encouraging, as MATT WADE reports.

THE First World’s reaction to great natural disasters, such as the Boxing Day tsunami, the Niger famine and the Pakistan earthquake, and to Third World poverty generally, is usually monetary aid.

At the United Nations General Assembly in September, the Prime Minister, John Howard, vowed to double the overseas aid allocation to about $4 billion a year by 2010, as Australia joined other wealthy nations in pledging billions of dollars in additional aid and debt relief for poor countries.

But this year has also been the UN’s International Year of Microcredit — a scheme to promote the use of tiny loans to help impoverished families increase their incomes. While it has received less attention than natural disasters and political rhetoric, this method of helping the poor is flourishing.

Microcredit is the provision of small, collateral-free loans and other financial services, mostly to very poor women who would normally be excluded from mainstream financial institutions. Loans of about $150 to $200 are used to start or expand small income-generating activities.

The *State of the Microcredit Summit Report* says the number of very poor people receiving a small loan grew from 7.6 million in 1997 to last year’s 66.6 million, an average annual growth of 36 per cent.

It is possible that 1100 million people will receive a microloan this year — that’s five times the population of Australia. The report estimates that more than 80 per cent of microloans for the poor are taken by women. ‘The increase represents an additional 45.3 million poorest women reported as receiving microloans in the last five years,’ it says.

Bangladesh, once synonymous with famine and natural disasters, has become the showpiece for the effectiveness of microcredit. Millions of microloans have been made in Bangladesh and research by the World Bank, an advocate of...
A World Bank researcher, Shahidur Khandker, studied three Bangladeshi groups that provide microcredit — the Bangladesh Rural Advancement Committee, Grameen Bank and a government program called RD-12. Khandker concluded that 3 per cent of clients got out of poverty each year because of their microloans and that microcredit accounted for 40 per cent of the reduction of moderate poverty in rural Bangladesh.

The UN Development Program’s Human Development Report found that Bangladesh had overtaken its giant neighbour India in reducing child mortality, despite having lower average incomes and a lower economic growth rate. It said Bangladesh had achieved rapid human development and the prevalence of microcredit had helped.

Microcredit had been especially important in expanding choice and empowering women. ‘While disparities still exist, women have become increasingly powerful catalysts for development, demanding greater control over fertility and birth spacing, education for their daughters and access to services,’ the Human Development Report says.

Microcredit for the poor was first tried in the early 1970s and has become an integral part of the drive to alleviate poverty. Initially, the idea of using loans to help the poor was treated with suspicion by many aid agencies. But the strategy’s success in generating income for poor families meant it could not be ignored.

Most big aid agencies now have microcredit projects. Thousands of organisations specialising in microcredit have also emerged.

Opportunity International, which made more than a million microloans last year, says the average loan in developing countries is about $180 over six months. It says 87 per cent of its loans go to women and each loan affects more than seven people on average. It has a global repayment rate of 98 per cent — better than many commercial banks.

Many microcredit organisations resemble traditional financial service firms, carrying banking licences and offering a range of products for poor clients, such as insurance. There are also ratings companies that assess the credit-worthiness of the major microcredit organisations. Some of the world’s biggest financial firms, such as Citigroup, Deutsche Bank, ABN Amro, HSBC and ING have recently become involved in microcredit.

RESULTS Australia says microcredit can help the world achieve one of the Millennium Development Goals — to halve the number of people living on less than US$1 a day by 2015.

‘Microfinance, while not a panacea, is still the best tool we have to reduce poverty among the very poor,’ the RESULTS report says.

However, the Australian government devotes a surprisingly small amount to this form of poverty alleviation — $14 million of its $2.5 billion aid budget. Considering the Howard Government’s philosophical commitment to small business, this is peculiar.

The national manager of RESULTS Australia, Maree Nutt, says more government money must be put into microcredit. ‘The percentage of Australian aid funding allocated for microfinance has reached a plateau in recent years. Our goal is to see an increase in spending to around $40 million per year within the next two years. This could bring its allocation to around 1.2 per cent — not unreasonable, given its effectiveness in helping to reduce poverty, particularly in the lives of very poor people.’

Bruce Billson, who, as the parliamentary secretary for Foreign Affairs and Trade is responsible for the aid program, says he is all for microcredit and has indicated there will be further spending on it. ‘Our commitment to microcredit is significant and it is an important part of our overall aid program. I’m optimistic we are going to see more support going into this area.’

Nutt wants the government to concentrate new spending on helping small-loan providers to get started or to expand their capacity. ‘Our aid funding can play an important role in this initial phase,’ she says. ‘Once a program begins to cover costs, more funds for future expansion can be accessed from commercial and private investors. The donor can make its exit but the service remains.’

CHAPTER 8

SUMMARY

Defining economic development and development economics

• Once, economic development was seen as the same thing as economic growth. In other words, it was thought that growing the level of national production or GDP was all that was needed to make people better off.

• However, from the 1980s onwards, economic development was seen more broadly as the economic, social, political and institutional changes needed in low-income countries, to improve material aspects (increased per capita levels of income and consumption) and non-material aspects (e.g. increased literacy, life expectancy, health) affecting the quality of daily life for ordinary people.

Measurement of and trends in economic development

Economic development is a tricky thing to measure, especially using a composite or single measure. Several measures are commonly used:

• Average GDP per capita represents the total annual value of goods and services produced by a nation divided by the population size. This single measure suffers from many weaknesses including unrecorded subsistence production, unevenness in the distribution of goods, services and incomes, the failure to take account of negative externalities or costs, and the failure to take account of the quality of people’s daily lives.

• The human development index (HDI) is a composite measure. It is based on both an economic indicator (i.e. GDP per capita, with the figure adjusted or standardised to remove variations in the actual purchasing power of money in different countries — called purchasing power parity or PPP expressed in US$) and social indicators (i.e. life expectancy at birth and education standards shown by adult literacy rates). Critics claim this index is inaccurate, subjective and narrow.

• Millennium Development Goals and their measurement. The UN measures progress in achieving its eight key Millennium Development Goals, through around 60 separate indicators. This is a much broader approach to measuring economic development, but having so many indicators makes overall comparisons or ranking of countries harder.

Causes of poverty in low-income countries

Many theories have been used to try to explain the causes of economic development. Some have seen development as going through stages of economic growth. However, despite great differences that exist between countries, low-income countries commonly face the following obstacles.

• The problem of limited productive capacity or PPF due to a low efficiency or volume of resources

• Low levels of saving and investment cause the vicious cycle of poverty

• Rapid population growth creates pressure on farming land, infrastructure and government finances, and adds to high labour force unemployment rates

• The lack of democracy and freedom contribute to poor government, incompetence and corruption

• Exports and foreign trade are limited, due partly to the trade protection policies of rich nations, along with high levels of foreign debt or interest repayments

• The existence of great inequality in the distribution of income and wealth contributes to poverty for some

• Some low-income countries were former colonies and exploited for their resources by European powers

Strategies to promote economic growth and development

Government policy and international assistance can help to accelerate economic development. One focus is to try to grow the country’s productive capacity or PPF, perhaps involving the following:

• Strategies to lift private and government investment levels, thereby breaking the vicious cycle of poverty

• Better provision of basic social and economic infrastructure to improve people’s living standards and encourage business expansion

• Keeping debt levels and the burden of interest repayments to sustainable levels
• Reforming government, including the promotion of democracy and free speech, making it more accountable
• Trying to persuade rich countries to move towards free trade and the removal of tariff protection, so that low-income countries can grow their export incomes and pay for imports
• Reducing inequality in the distribution of income and wealth so that the rich help to provide government revenue to fund infrastructure
• Reducing population pressures through better welfare for the aged, health care to lower infant mortality, family planning and education.

The role of government and private foreign aid to promote economic development

• Foreign aid refers to financial help (i.e. hard and soft loans, and gifts) and other assistance, usually given by richer countries to poorer countries.
• Aid can be official (government) or non-official (private). Often aid is used for projects that help to pursue the UN’s Millennium Development Goals.
• Australia gives nearly $6 billion annually in government foreign aid, or 0.36 per cent of our GDP.
• Aid goes to countries (especially in the Asia-Pacific area) including Papua New Guinea, Solomon Islands, Indonesia, Vietnam, the Philippines, East Timor and Fiji.
• Aid helps make up for the deficiency of saving and investment funds in poorer countries, and can help break the cycle of poverty by raising efficiency and per capita income levels.

Current issues facing a developing nation in Asia — Vietnam, a case study

• In the years since 1986 (the start of Vietnam’s economic reform program called ‘Doi moi’) there has been a shift from central planning to a more deregulated socialist-oriented market economy.
• Reforms have included the recognition of private ownership, implementing agricultural and land reforms to allow private farming and end agricultural collectives, setting up the necessary institutions for the freer operation of various markets (e.g. the capital market including the stock exchange, labour market and resource markets), opening the nation’s borders to foreign investment and trade, integration into the global economy, and encouraging ongoing structural change (shifting from a rural economy to an industrialised modern system by 2020).
• As a result of reforms, the rate of economic growth and economic development has accelerated; the average annual level of per capita income has increased almost sevenfold from US$200 to over US$1596, purchasing power has grown, poverty has been cut, and life expectancy and living standards increased.
• Despite progress, Vietnam faces challenges including inflation, the ongoing effects of the global financial crisis and ensuing uncertainty and recession (2008–09–10–11–12), corruption, inequality in living standards, infrastructure bottlenecks, energy shortages and environmental issues.
Development economics

- A specialised branch or area of Economics
- Looks at strategies to accelerate economic development in low-income countries

Economic development

- Used to be defined or seen as the same thing as economic growth
- Nowadays seen more broadly as social, economic, political and institutional changes needed to improve both material and non-material aspects affecting the wellbeing of ordinary people.

Measurement of economic development

Average GDP per capita is the average value of goods and services (or incomes) produced by a country in a year.

Weakness include
- Unrecorded subsistence output
- Inequality in distribution
- Negative externalities/costs
- Poor reflection of the quality of people’s daily lives.

Measures used for the millennium development goals (MDGs)
- Eight categories and 60 indicators used
- Difficulty making comparisons across countries since there are many indicators (not just one).

Human development index (the UN’s, HDI)
- Economic indicators (average GDP per capita at PPP)
- Non-economic measures (life expectancy and literacy rates)
- Index subjective and narrow.

Many causes of poverty in low-income countries

- Much inequality in income distribution
- Often inefficient, incompetent and corrupt government
- Rapid population growth
- Limited productive capacity or PPF
- Low levels of saving and investment lead to the poverty cycle
- Rich countries often restrict trade by subsidies and tariff protection
- Possible historical problems including colonialism

Strategies to promote economic growth and development

- Redistribute income and wealth more equitably—to narrow the gap
- Reform of government through democracy and freedom of speech
- Control rapid population growth (e.g. improved health, welfare, education)
- Grow productive capacity or PPF (especially increased efficiency)
- Boost saving and access to investment funds—break the poverty cycle
- Foreign aid
  - Official
  - Unofficial
  - Loans
  - Grants
  - Other assistance
- Pressure rich countries to adopt free trade/trade liberalisation

Current issues facing an Asian developing country—Vietnam, a case study
- Transformed from a planned socialist economy to socialist-oriented market economy since 1986
- Rapid economic growth has brought improvements in material and non-material living standards
- Challenges include inflation, the current global recession, globalisation, infrastructure bottlenecks, access to energy, trade deficit, corruption in government and an ageing population.
Elective for Unit 2, Outcome 2

An international economic issue selected by the teacher or students

You may recall that Unit 2, Outcome 2 of the course requires a study of any two of the contemporary global economic issues. These electives may be drawn from the following list of four topics:

- Australia’s international economic relationships
- Economic globalisation
- Development economics
- An economic issue selected by the teacher or students.

Already the first three of these electives have been covered in chapters 6, 7 and 8 of this text.

Check the VCAA Economics Study Design, 2010–16 for those wanting the freedom to explore the fourth elective — a global economic issue selected by the teacher or students.

Multiple-choice answers

Chapter 1 — Introduction: Australia, a market economic system

Chapter 2 — Economic growth and sustainable development

Chapter 3 — Australia’s inflation as a contemporary economic issue
1C, 2D, 3B, 4D, 5C, 6C, 7C, 8A, 9B, 10B, 11C, 12A, 13A, 14B, 15B, 16B

Chapter 4 — Creation and distribution of income and wealth as a contemporary economic issue
1B, 2A, 3D, 4C, 5A, 6D, 7A, 8C, 9B, 10B, 11D, 12A, 13C, 14A, 15B, 16D, 17B, 18D, 19A, 20A

Chapter 5 — Population, employment and change

Chapter 6 — Australia’s international economic relationships as a global economic issue

Chapter 7 — Economic globalisation
1D, 2A, 3A, 4A, 5A, 6C, 7A, 8C, 9B, 10D, 11D, 12B, 13B, 14A

Chapter 8 — Development economics
1C, 2C, 3B, 4C, 5D, 6D, 7B, 8B, 9D, 10A, 11D, 12C, 13B, 14C