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# *Economic Growth and Development*

MEGALECTURE

*A2 Economics*

# Economic Growth versus Development

- As discussed in the last unit, economic growth is not ends in itself but it is means to an end. It is development that economies wish to achieve.

# Economic Growth versus Development

- Unlike growth that only accounts for citizens' materialistic well-being, development is indicator of citizens' living standards that is not only affected by materialistic well-being but is also function of citizens' social, political and other non-materialistic well-being variables.

# Economic Growth versus Development

- Since growth is necessary but not a sufficient condition for development, hence policymakers along with ensuring high growth rates should be mindful of non-materialistic well-being aspects that affects citizens' living standards.

# Economic Growth versus Development

- Unlike growth that is solely calculated using changes in economies' real GDP per capita, developmental indicators gauge economies' well-being on materialistic and non-materialistic well being dimensions to be able to provide holistic perspective concerning economies' quality of life.

# Economies' Classification based upon Income Levels

World Bank classifies economies in different groups based upon their national income levels.

Countries are divided into following four income groups to estimate their development

levels: **1. Lower Income**

**2. Lower-Middle Income**

**3. Upper-Middle Income**

**4. Upper Income**

## Economies' Classification based upon Income Levels

- The lower and lower-middle income economies are generally known as **developing** whereas countries in other two groups are classified as developed economies

# Benefits and Costs of Economic Growth

- As discussed in last unit, economic growth does not come without any costs. Hence these costs need to be balanced with growth's potential economic and non-economic benefits to ensure achievement of higher development levels.
- Though growth improves citizens' consumption possibilities but in case goods and services that improve nationals' **non-materialistic well-being** are not available then development will obviously be not a natural consequence of economies' growth.



# Benefits and Costs of Economic Growth

- Developing economies' growth is often result of increased investment and entrepreneurship of privileged classes that are generally the only beneficiaries of economies' limited economic opportunities.
- Unequal access to capital other than unequal access to basic necessities of life also significantly limit income mobility of disadvantage classes.

# Benefits and Costs of Economic Growth

- Seclusion of certain segments from economies' growth and development has recently resulted in development of severe social problems including higher crime rates.
- It is not surprising to know that economies' metropolitan centers where pressure to sustain higher living standards is high are often more victim to such social problems.

# Benefits and Costs of Economic Growth

- With recent emergence of climate change and international terrorism related challenges, development has become even more global concept than being country specific.
- Collective action is needed to ensure development of appropriate measures to combat these challenges.

# Benefits and Costs of Economic Growth

- Division of international community in sovereign countries has resulted in emergence of dominant firms / organizations / institutions and states that have **monopolized** world / local resources and has resulted in unnecessary excessive spending on useless defense products.

# Economic Growth

- As stated earlier, increase in economies' output is reliable indicator of their economic well-being.
- Percentage change in economies' real GDP is used to estimate their economic growth. Though higher economic growth is always **preferred** by economies but they should be careful of the costs at which they are experiencing this growth.

# Economic Growth

- Low but stable and sustainable economic growth should be preferred over high but unsteady and **unsustainable growth patterns.**

# National Income Statistics as indicator of Living Standards

- Though economists often use change in real GDP per capita as an indicator of living standards of any economy's citizens but this proxy might at times prevent reliable and valid estimations.
- Though GDP is often **reliable indicator** of any economy's material well-being but this surely do not provide holistic perspective concerning countries' living standards or as commonly known quality of life.

## National Income Statistics as indicator of Living Standards

- Since **materialistic well-being** of any individual/economy is one aspect of their welfare, which depends upon a lot of other variables as well, therefore GDP can never be a very good indicator of any economy's citizens' quality of life.



# Critique of using GDP as indicator of Development

- Though so far we have agreed that national income statistics as calculated through GDP/GNP provide realistic estimate of any economy's materialistic well-being but this might also not always be true.
- Since GDP per capita is an average number that we arrive by dividing total national income by the population of any given economy; meaning that depending upon nature of income distribution some of its citizens might be earning much less than GDP per capita.

# Critique of using GDP as indicator of Development

- Moreover since GDP/GNP just calculate the national income generated through any production process and it does not take account of type of goods/services that are produced therefore these statistics can at times provide **distorted view** of any economy's materialistic well-being.

## Critique of using GDP as indicator of Development

- For instance if both Pakistan and Malaysia on average experience similar economic growth but unlike Pakistan where most of increased production is of **military goods** if Malaysia's increased growth is due to increased production of consumer and capital goods then definitely in reality latter will have higher material well-being.

# Critique of using GDP as indicator of Development

- Moreover because hidden economy being **undocumented economic activity** also affects citizens' consumption possibilities therefore some appropriate adjustments in economies' national income statistics to account for their hidden economy is needed for these statistics to be better predictors of citizens' material well-being.
- Illegal economic activity and incentives to avoid taxation are reasons for formation of **hidden economy**.

# Critique of using GDP as indicator of Development

- The difference between economy's GDP as calculated through expenditure and income method can be an appropriate way to estimating the size of economy's hidden economy. This is because people will spend according to their **purchasing potential** even if they have understated their real incomes in official records.

# *Critique of using GDP as indicator of Development*

- Poor institutional framework of developing economies often results in them having larger size of hidden economies.*
- Furthermore, if economic growth is not sustainable then it means that current generations are experiencing higher economic well-being at the expense of their future generations.*

# Critique of using GDP as indicator of Development

- Rapid depletion of economy's resources adversely affects its future production possibilities and as a result it threatens its future generations high material well-being. Therefore as stated earlier, economies should be mindful of the fact that high economic growth rate is not coming at the expense of future generations' living standards.
- Similarly increased **environmental degradation** will result in loss of economic growth in the longer run because of government's treatment of societal damage.

# Critique of using GDP as indicator of Development

- Similarly if an economy is facing **high growth rates** but working hours have also substantially increased then obviously national income statistics will be providing distorted view of economies' material well-being.



# Critique of using GDP as indicator of Development

- Similarly economies' greater production of capital goods might result in comparatively lower materialistic well-being in shorter term but it will definitely allow these economies to achieve higher economic well-being due to their enhanced long term production potential.
- Therefore economies should consistently be making **adequate investment** in their production potential to enhance their long term production possibilities. This includes capital goods and investment in infrastructure.

## *Critique of using GDP as indicator of Development*

- *Though generally economic output is valued at market prices but since most governmental projects are not for profit purposes therefore market prices of public goods (if any) is not a good representative of their real value. Hence monetary estimation of government expenditure for GDP calculations purposes is always problematic.*

# Critique of using GDP as indicator of Development

- Non-marketed goods/services are not part of economy's official income statistics. Domestic services like baby sitting done by grandparents will not be part of Pakistan's GDP whereas it will be most probably part of any developed economy's GDP. Hence this can be one reason of under-estimation of our economy's material well-being.

# Critique of using GDP as indicator of Development

- Similarly if improved material well-being is coming at the expense of increased work pressure then obviously national income statistics will **overstate** an economy's material well-being.

# Comparison of Economic Well-Being across Countries

- For comparison of economies' material well-being their real GDP per capita needs to be converted in common currency. This might be done using prevalent exchange rates but these exchange rates often do not account for purchasing power of various currencies. Therefore **Purchasing Power Parity** (PPP) is the exchange rate that accounts for currencies purchasing power in local economies.

# Comparison of Economic Well-Being across Countries

- For instance if current exchange rate between US dollar and Pakistani rupees is  $\$1 = \text{Rs } 100$  but the amount of goods/services  $\$1$  can purchase in US requires Rs 120 to purchase in Pakistan then Purchasing Power Parity between the two countries will be  $\$1 = \text{Rs } 120$
- Hence this **PPP** should be used to convert economies national income statistics in common currency rather than using their exchange rate.

# Economic Growth versus Development

- Unlike economic growth that just accounts for increase in economy's output (national income), development or as known as economic development accounts for changes in citizens' living standards or quality of life. Hence development indicators include all aspects that are expected to affect an individual's quality of life like his/her social and political well-being.

# Economic Growth versus Development

- Therefore unlike changes in real GDP per capita, development indicators/statistics provide more **holistic perspective** of citizens' living standards.



# Development

- Since materialistic needs including basic necessities for life like food, clothing, shelter can only be met by means of adequate income levels therefore development indicators do include proxies for individuals' income but they also account for variables that are expected to affect their social and political well-being.

# Development

- Nobel prize holder economist , Amartya Sen, explained developed as availability of opportunities. He explained opportunities as choices available to individuals to achieve their personal and professional **potential**.

# Development Indicators

- Human Development Index (HDI) was developed by Pakistani (Mahbub-Ul-Haq) and Indian economists (Amaryta Sen) in 1990.
- The HDI score ranges from 0 to 1. Most developed economies are given a score of 1.
- This development statistic evaluates economies on following three dimensions:
  - **National Income**
  - **Health Care**
  - **Education**
- The indicator uses certain proxies to capture economies' performance on above mentioned dimensions.

# Human Development Index (HDI)

- Real GDP per capita is used to capture countries' performance on **materialistic well-being**.
- Life expectancy at birth is the proxy used to estimate economies' **health care services**.
- Expected Years of Schooling and Mean years of **schooling**.

# Human Development Index (HDI)

- By inclusion of more dimensions like **political freedom, national and international mobility** etc the index can be improved to provide more comprehensive picture of economies' development but then absence of data can substantially limit its usefulness for comparison among different nations.

# Human Poverty Index (HPI)

- Unlike HDI that records availability of materialistic, educational and health care opportunities, HPI evaluates economies on their deprivation in terms of basic necessities for life.
- It is now known as Multidimensional Poverty Index.
- The index evaluates economies on following dimensions:
  - **Education**
  - **Health Care**
  - **Living Standards**

# Dimensions of Poverty

- **Health:**

1. Nutrition

An adult under 70 or child is malnourished

2. Child mortality

Any child under 18 died before completion of survey

# Dimensions of Poverty

- **Education:**

- Years Schooling:

No household member aged 10 or older has completed six years of schooling

- 2. School Attendance:

A school aged child's not attending school at the age in which they would complete class 8



# Dimensions of Poverty

- *Standard of Living:*

1. *Cooking Fuel:*

- The house cooks with dung, wood, charcoal or coal

2. *Sanitation:*

The household's sanitation facility is not approved

# Dimensions of Poverty

- *Standard of Living:*

## 3. Drinking Water

Household doesn't have access to improved drinking water

## 4. Electricity

The household has no electricity

# Net Economic Welfare (NEW)

- **Net Economic Welfare (NEW)** is another famous development indicator that is used to gauge economies' extent of development.
- Unlike HDI and HPI, Net Economic Welfare (NEW) uses countries' real GDP per capita as the starting point and by assigning monetary values to economic goods and bad that are expected to positively and adversely affect individuals' well-being are added and subtracted from their income statistics to reach a new development statistic.

# Net Economic Welfare (NEW)

- This index was developed in **1972** and is at times also referred to as Measurable Economic Welfare (MEW).

# Comparison of Development Statistics/Indicators

- Since development indicators evaluate different aspects/dimensions of economies' development therefore they should be collectively used to better comprehend countries' development trajectories.

# Comparison of Development Statistics/Indicators

- However in cases when some specific issue of development has to be evaluated then definitely it will be better if **specialized proxies/indicators** are used to in-depth study about the research question.