

Principles and Applications of Economic Geography

Economy, Policy, Environment

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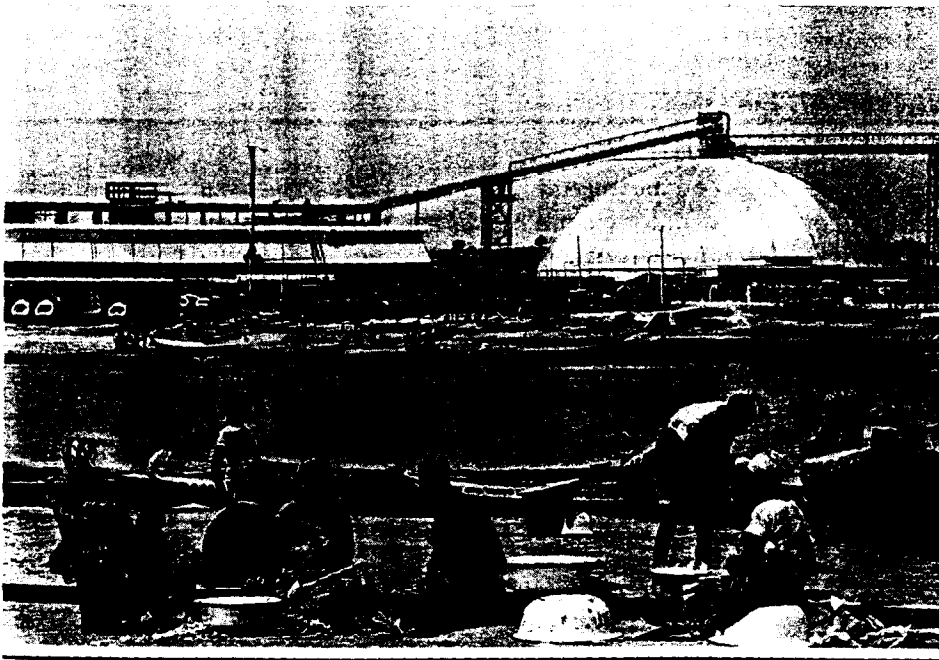
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Chapter 11

Economic Growth and Development: National Patterns and Processes

This chapter

- contains a description of the global distribution of rich and poor countries
- emphasizes the importance of human capital as the basis of economic growth
- suggests the differences between economic development and economic growth
- details some of the regional effects of economic development
- outlines models of economic development that focus on a country's internal conditions
- considers the effects of trade on a country's economic development
- reviews the debt problems of the developing countries
- describes the potential benefits of FDI for economic development and the role of MNCs in fostering economic growth



Courtesy of The World Bank.

We have already considered some issues in regional economic growth in Chapter 9. This chapter raises some additional issues, but now our attention will be focused on national rather than local and regional concerns. Another difference between this chapter and Chapter 9 is in locational emphasis. The discussion of regional growth largely concerned disparities in economic conditions across regions in wealthy countries. Now we'll consider the economic problems of entire countries, especially the poorer ones. Beyond the change in geographical scale and location, our concern in this chapter goes beyond economic expansion in poorer countries to their full economic development at a time when opening international markets require these countries to balance domestic priorities with the practical realities of global competition.

Keep in mind as you read this chapter that the geography of economic development has experienced significant historical changes. Right now, the highest living standards around the world, on average, are in a limited number of countries in West Europe, North America, and East Asia. It wasn't so long ago however, by historical standards, that many of these places were crude and undeveloped as compared to the world's most developed regions in China, India, and even earlier in Egypt and other parts of the Middle East. It could easily be, in the not too distant future, that an entirely different set of places will be considered "most developed."

NATIONAL INCOME

National wealth can be measured in a variety of ways. The extent of a country's territory could be used, for example, as a measure of its resource base, and in the past it was certainly a strong indicator of its prestige and political and military strength. Not too long ago, the amount of gold that a country held in its national treasury was the standard measure of wealth. Gold was (and is) valued across cultural and political boundaries around the world and was easily used to make purchases before contemporary monetary systems were established. The current international standard for measuring a country's wealth, however, doesn't have to do with how much gold it has or its command over natural resources. Instead, the current standard focuses on the amount of production that occurs in a country as measured by either its gross national product (GNP) or gross domestic product (GDP).

Values of GNP and GDP are taken from a system of *national accounts* which attempt to measure the activity or output of an economy. The details of the

measure of GDP and GNP, which are closely related amounts, are described in Insights 11.1, but in simple terms they are the sum in money terms of the value of output of goods and services produced in a country's economy over the period of a year. (Many countries measure their output over shorter terms, especially for calendar quarters of three months. For our purposes, however, GNP and GDP values are annual ones.) It's important to keep in mind that using output as a standard of national wealth is drawn from a system of Western values that include the idea that economic growth is a virtue in and of itself. The contemporary measures of national wealth, therefore, are drawn from a particular cultural context.

The world's largest economy is that of the United States, and this has been the case for some time (Table 11.1). In the mid-1990s, the U.S. economy was followed by Japan's, Germany's, France's, and Italy's. If you add the United Kingdom's economy to the list, you have the six national economies that had output valued in U.S. currency at over one trillion dollars (\$1,000,000,000,000). In the mid-1990s the combined output of those six economies was greater than the combined output of all the other countries of the world.

Table 11.1 The World's 20 Largest Economies in 1993

Country	GNP (×1,000,000)	Per Capita GNP	Population (×1,000,000)
United States	\$5,935,496	\$23,240	255.4
Japan	3,509,655	28,190	124.5
Germany	1,856,218	23,030	80.6
France	1,277,724	22,260	57.4
Italy	1,182,588	20,460	57.8
United Kingdom	1,028,262	17,790	57.8
Canada	567,454	20,710	27.4
China	546,234	470	1,162.2
Spain	546,227	13,970	39.1
Brazil	426,303	2,770	153.9
Russia	373,990	2,510	149.0
Netherlands	311,296	20,480	15.2
Australia	302,050	17,260	17.5
South Korea	296,723	6,790	43.7
Mexico	294,950	3,470	85.0
India	273,916	310	883.6
Switzerland	248,952	36,080	6.9
Sweden	234,987	27,010	8.7
Belgium	208,800	20,880	10.0
Argentina	200,255	6,050	33.1

SOURCE: World Bank, *World Development Report 1994* (New York: Oxford University Press).

➤ INSIGHTS 11.1
How GNP and GDP Are Calculated

Gross national product (GNP) and gross domestic product (GDP) are measures of national income that are rooted in the national product identity developed by the influential economist John Maynard Keynes. That identity is

$$\text{National Product} = \text{Consumption} + \text{Investment} + \text{Government Spending}$$

The terms “national product” and “national income” are virtually synonymous. National product is measured as the sum in money of the flow of final goods and services in an economy. (Final goods and services are consumed as products in themselves, and not as parts of other products.) National income is taken as the sum of earnings in the economy, including both wages and other factor costs of production as well as profits. This brings us to another accounting identity:

$$\text{Price} = \text{Cost} + \text{Profit}$$

with price taken from the product account and cost and profit calculated as income because they are the payments to either factors of production or producers. That’s why product and income amounts are equal, and the terms national “product” and national “income” are synonymous.

The accompanying table summarizes the components of GNP and GDP in a general way. Consumption refers, again, to final goods and does not include used, second-hand, merchandise. It also doesn’t include the large part of any country’s economy that is “off the books,” including illegal purchases and transactions in what is called the *informal sector*. The informal sector includes cash and barter transactions that are part of everyday life in most places, but go unrecorded by government agencies. In poorer countries, the informal sector is often quite large and actually accounts for a large share of national employment. The informal sector exists at a smaller scale in wealthier countries where transactions are more easily monitored by third parties because the same technology that facilitates the transactions also facilitates recording them.

Gross capital formation, or investment, comprises new structures and machinery that help the economy advance its production. The word “gross” is important here. Remember, we’re talking about gross national and domestic products, not “net” products, so depreciation is not a consideration in this type of accounting system. This limitation has led to recent criticism of standard national accounting procedures for not subtracting the value of natural resources lost in production from the measure of national wealth. In fact, because gross measures are used, the faster resources are consumed, the wealthier a country appears to be. This type of accounting is not useful at all when a measure of sustainability of a country’s economy is needed. (Sustainable development is taken up in the next chapter.)

An economy’s international activity is taken into account by netting out its

trade: exports less imports, and adding that value to consumption of domestic production and investment to arrive at GDP. When the net value of factor income derived from foreign sources is added to GDP, the result is GNP. The basic difference between the two measures is that GNP is the income of a country's citizens, wherever they might live, and GDP is the income of the country's resident population. Most countries around the world now use GDP as the basic measure of their economies, and calculate it on a quarterly and calendar-year basis. The calendar GDP or GNP, when divided by the country's population, yields per capita GDP or GNP, respectively.

The United Nations' National Accounting System

+ Consumption
 + Gross capital formation (investment)
 + Exports
 - Imports
 = Gross domestic product
 + Net factor income from abroad
 = Gross national product

MEASURING LIVING STANDARDS

Gross output measures such as GDP and GNP tell us about the wealth of a national economy on an aggregate basis, but they often mask variations in standards of living that exist across countries. For example, three countries, Canada, China, and Spain, had about the same GNP in 1993, but the standards of living for the "average" person in each country was different. The most commonly used measure used in assessing a country's average standard of living is *per capita GNP* (or *GDP*), which is simply a country's GNP divided by its population, or GNP per "head." In 1993, Canada's per capita GNP was \$20,710, about 50% larger than Spain's \$13,970 and more than 40 times larger than China's \$470. The three countries had about the same GNP despite the differences in their per capita GNP because of the differences in the size of their populations. China is the world's most populous country, by a long shot, so even though its per capita GNP is small, its aggregate output is huge. Spain's population is about 50% larger than Canada's, and that compensates for its smaller per capita GNP in roughly equating its aggregate output with that of Canada, the country with the smallest population of the three.

The use of per capita GNP as a measure of a country's standard of living has been criticized on a number of counts. One problem with using this measure is that it is almost always expressed in U.S. dollars when international comparisons

are made. Changes in exchange rates between the U.S. dollar and a country's own currency can cause changes in GNP figures when no real changes have occurred in a country's economy. Furthermore, prices of goods and services that can't be traded, such as housing, can be very different among countries. Such price differences can't be accounted for in per capita GNP, but they can have quite an impact on standards of living.

Recently, efforts have been made to comprehensively measure *purchasing power parity* across countries. This parity indicates the buying power of the average person in a country in an "international dollar" (which is very closely related to the U.S. dollar but is not so subject to exchange rate changes). In general, when purchasing power parities are used rather than values of per capita GNP, the disparities in living standards between richer and poorer countries are lessened. As indicated in Figure 11.1, the purchasing power of the average person

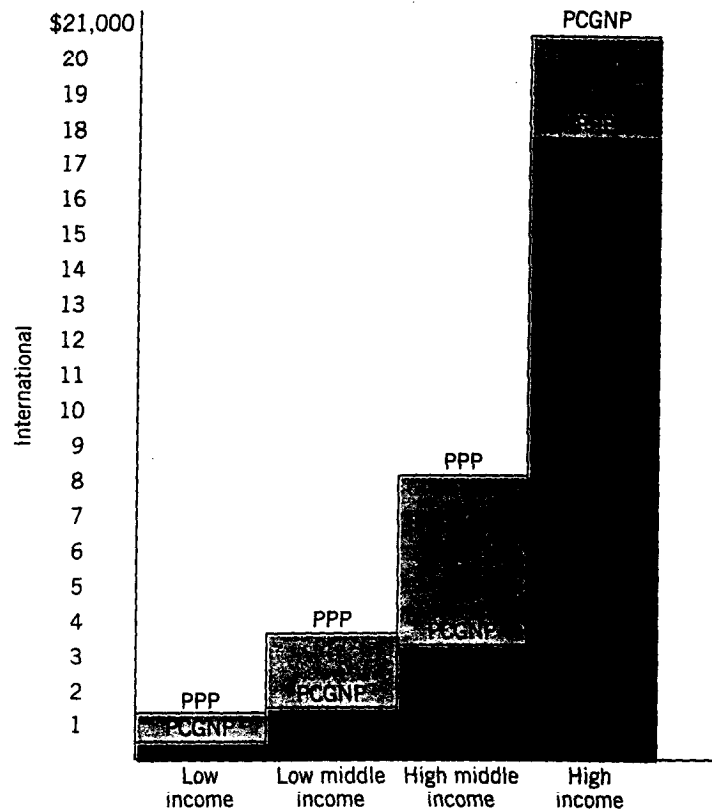


Figure 11.1 The purchasing power parities (PPP) of countries and their per capita GNPs (PCGNP) are similar on average, but lower income countries tend to have their purchasing power underestimated by their per capita GNP and the world's highest income countries tend to have their relative purchasing power overestimated by their per capita GNPs. SOURCE: World Bank, 1994: *World Development Report 1994* (New York: Oxford University Press).

in poorer countries is higher than would be indicated by the country's per capita GNP. The reverse holds for the richer countries, with their purchasing power parities falling below their average per capita GNPs. Even though these parities lessen the measurable discrepancy in living standards between rich and poor countries, as compared to the discrepancies indicated by per capita GNP, the differences are still great. The average purchasing power in the world's poorest countries is just over \$1,100 per person per year, but it is nearly \$18,000 per year (international dollars) in the world's richest countries.

Using purchasing power parities as a measure of national living standards has also been criticized because it considers, as does per capita GNP, that an individual's consumption of goods and services is all that matters in their quality of life. Alternative measures of living standards often consider other factors, in addition to consumption, as contributing to living standards. For example, literacy rates, access to health care and employment, infant mortality, and other related measures have been used in various comparisons of international living standards. In one of these types of assessments, the United Nations puts a limit of \$5,000 on per capita GNP's contribution to an index of human development that it compiles. The limit is designed to suppress the overstatement of living standards, on a comparative basis, that can occur in the case of countries with higher per capita GNPs.

RICH AND POOR COUNTRIES

Throughout this book, we have used per capita GNP to classify the world's countries into four groups: low income, low middle income, high middle income, and high income. In most circumstances where this distinction is drawn, it reveals important differences among the world's countries: differences in population, agricultural practices, trade, and so on, and in purchasing power parities as well. You probably are also aware that locational differences exist among the world's countries when they are classified by their per capita GNP. Most of the world's richest countries are found around the North Atlantic, especially in West Europe, and some are in East Asia and in the Southwest Pacific (Figure 11.2). The world's poorest countries, called the *least developed countries (LDCs)* by the United Nations, are mostly in Africa. They are also found in the South Pacific and in South Central and Southeast Asia (Figure 11.3). Haiti is the only LDC in the Western Hemisphere. The general geography portrayed in the maps of rich and poor countries has led to the almost literal geography of a *North-South division* of the world based on national wealth and development. Aside from such obvious exceptions as Australia and New Zealand, the world's richest countries are found in a northern tier, while its poorer countries are located to their south. Although the geography of North and South is far from perfect, many people consider the term useful because it emphasizes a clear-cut distinction between the world's poor and rich countries.

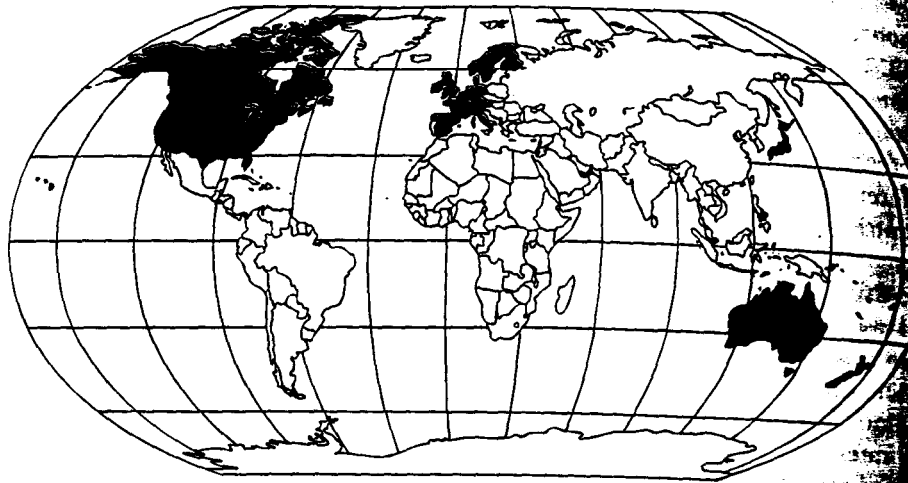


Figure 11.2 The world's richest economies, as measured by per capita GNP, are geographically clustered in West Europe, North America, and the West Pacific Rim. SOURCE: World Bank, 1994: *World Development Report 1994* (New York: Oxford University Press).

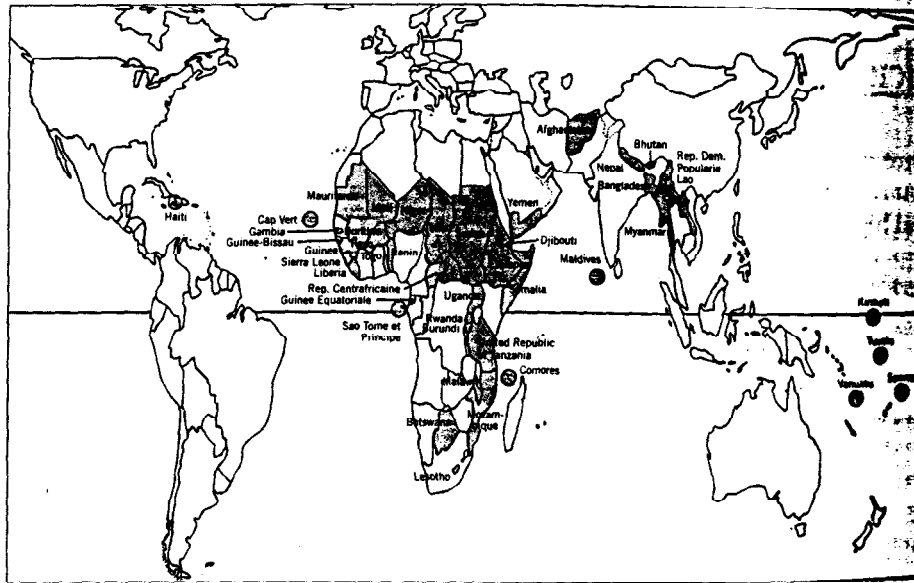


Figure 11.3 The world's poorest economies, as measured by per capita GNP, are found in what the United Nations calls the least developed countries (LDCs). Most of the LDCs are in Africa, with secondary clusters in the Pacific and in Southeast Asia. SOURCE: United Nations Conference on Trade and Development, 1992: *Paris Declaration and Program of Action for the Least Developed Countries for the 1990s* (New York: United Nations), p. viii.

In the context of Western values, big is beautiful and growth is good. Large GNPs are better than small ones, high per capita GNPs suggest individual well-being, and economic growth is an appropriate objective of every government of every country. *Economic growth*, meaning an increase in an economy's output, is necessary under currently dominant production systems and values to ensure both the maintenance and improvement of living standards. If a country's economy grows faster than does its population, then per capita GNP will increase over time. If GNP grows at the same rate as population, the average rate of consumption won't grow, but at least it will be maintained. Unfortunately, in recent years the very countries that are most in need of economic growth have been experiencing declines in the size of their economies while their populations continue to grow (Figure 11.4). From 1980 through 1992, the average low-income and low-middle-income countries experienced absolute declines in their economies once inflation was taken into account. Ironically, the only countries that experienced real economic growth during the period, on average, were those that already had high values of per capita GNP. It seems that the adage "it takes money to make money" holds for countries as much as it does for individual people.

Actually, the 1980–1992 period was a particularly bad one for many economies around the world, but the general relationship of stronger growth in the world's richer countries than in the world's poorer countries is a consistent one in other time periods, too. Why is there a consistent difference in growth rates,

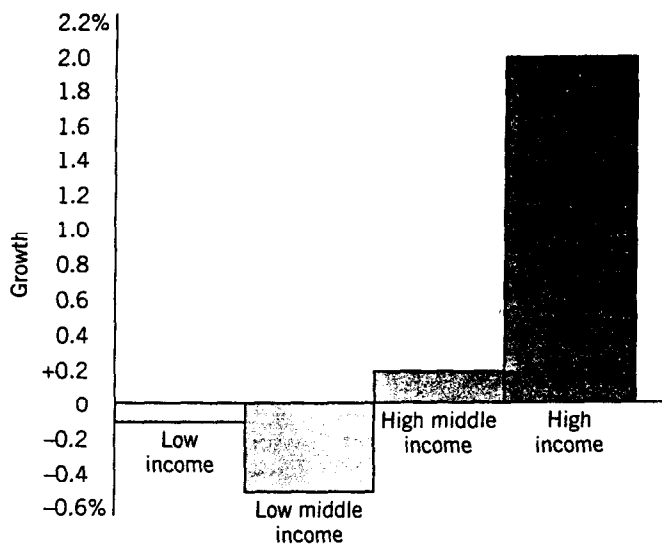


Figure 11.4 On average, GNP declined annually from 1980 through 1992 in the world's poorest countries. Although GNP experienced slight annual increases in the high-middle-income countries during that period, its annual growth rate in the world's richest countries was a relatively high 2%. SOURCE: World Bank, 1994: *World Development Report 1994* (New York: Oxford University Press).

with higher rates typical of rich countries and lower ones typical of poorer ones? This is a big question, with no certain answer. However, a number of characteristics distinguish rich countries from poor ones, beyond their different incomes, which may provide the foundation for the gap between rich and poor in rates of economic growth. One important difference between the two is that the rich countries are more likely to benefit from economies of scale. Internal economies of scale require larger levels of output that, in turn, are dependent on having larger markets. Rich countries, almost by definition, are larger markets than poorer ones and so are more likely to achieve economies of scale in their production. Apparently, the higher rates of economic growth in richer countries are due in large part to the benefits of economies of scale. And these benefits allow the rich to get richer.

Rough measures of economic efficiency, or productivity, across the national

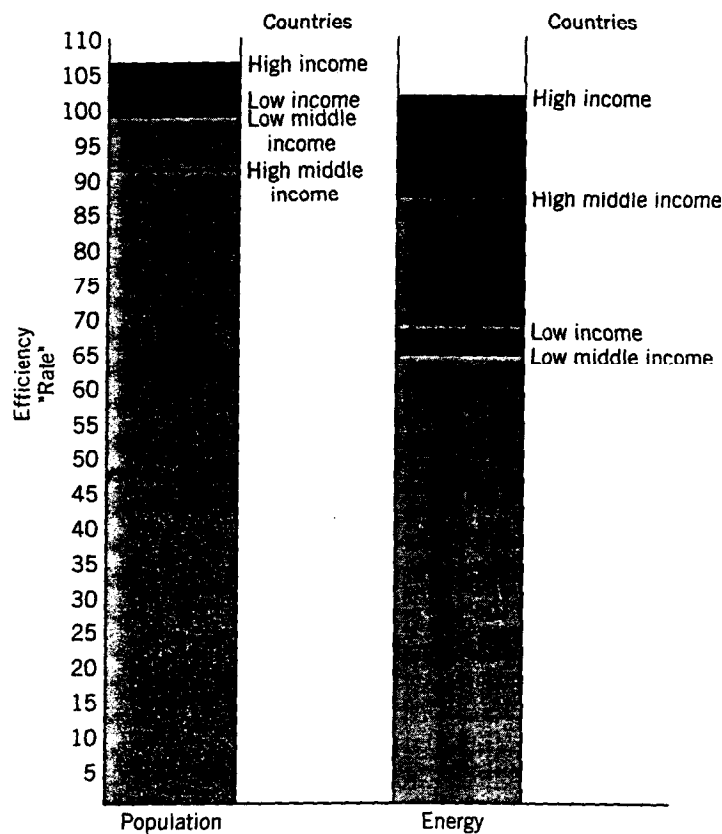


Figure 11.5 Productivity with respect to population was roughly consistent regardless of national income in 1990. Productivity with respect to energy was not consistent, however, but varied with average national income. SOURCE: D. M. Hanink, 1994: *The International Economy: A Geographical Approach* (New York: John Wiley & Sons).