CHAPTER

18

Issues of Economic Development

CONCEPT REVIEW

Free enterprise system is another name for capitalism, an economic system based on private ownership of productive resources.

CHAPTER 18 KEY CONCEPT

A **transitional economy** is a country that has moved (or is moving) from a command economy, such as communism, to a market economy.

WHY THE CONCEPT MATTERS

The development of the world's less developed countries has grown increasingly important as globalization has taken hold. Promoting development also promotes good government and economic opportunity in less developed countries. When a nation's government is democratic and stable and its citizens are prosperous, the benefits reach beyond that emerging economy to the world community, which gains a new economic and political partner.

Online Highlights

More at ClassZone.com

Economics Update

Go to ECONOMICS UPDATE for chapter updates and current news on trade and China's transition to a market economy. (See Case Study, pp. 570–571.) ▶

SMARTGrapher

Go to SMART GRAPHER to complete graphing activities in this chapter.

Interactive Review

Go to INTERACTIVE REVIEW for concept review and activities.

How has international trade helped China make the transition to a market economy? See the Case Study on pages 570–571.

SECTION 1

Definitions of Development

OBJECTIVES	KEY TERMS	TAKING NOTES
In Section 1 you will • determine how economic development is defined • explain how certain indicators can illustrate the level of economic development of a nation	developed nations, *p. 544* transitional economies, *p. 545* less developed countries (LDC), *p. 545* infrastructure, *p. 545* per capita GDP, *p. 546* infant mortality rate, *p. 547* life expectancy, *p. 547* literacy rate, *p. 547* human development index (HDI), *p. 547*	As you read Section 1, complete a summary table like the one shown. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

Definitions of Development	
Levels of Development	Standards of Economic Development

Levels of Development

KEY CONCEPTS

Do you have at least $1 in your pocket at the moment? If so, you have more money than over a billion of the world's people have for food, shelter, and clothing for today. Economists gather this type of data to compare the economies of nations and the impact of those economies on people's standard of living. They use the data to measure the nations' level of economic development.

QUICK REFERENCE

Developed nations have a market economy, a relatively high standard of living, a high GDP, industrialization, widespread private ownership of property, and stable and effective governments.

Developed Nations

Economists have defined three major levels of economic development. The nations with the highest standards of living are known as **developed nations**. In addition to a relatively high standard of living, these nations have a market economy, a high GDP, industrialization, widespread private ownership of property, and stable and effective governments. The nations of Western Europe, the United States, Canada, Australia, New Zealand, Japan, and South Korea are all developed nations.

You can identify some of the features of a developed nation by looking around you. Most people live fairly comfortable lives and enjoy such consumer goods as television sets, washing machines, and cars. You will also see that most people live in urban areas, where they have jobs in service and industrial enterprises: banks, insurance companies, auto parts manufacturing, and so on. Even though few people work in agriculture, the nation produces a surplus of agricultural products using advanced science and technology and highly efficient farming methods. You will also see that, on the whole, people are generally healthy and well-educated. They have political and economic freedom, and they exercise those freedoms in pursuit of well-being. You will see exceptions to all of these features—poverty, unemployment, poor living conditions—but they are not the prevailing features of the society.

Transitional Economies

Economists have also defined the development that occurs in **transitional economies**. These are countries that have moved (or are moving) from a command economy to a market economy. China, Russia, and a number of Eastern European countries are considered to be transitional economies.

Poland, in Eastern Europe, is in transition and categorized as a less developed country. Like other transitional economies, however, it is on a clear path toward improving standards of living. As democracy and economic freedom begin to take hold, Poland's economy and its citizens' quality of life have steadily improved.

QUICK REFERENCE

A **transitional economy** is a country that has moved (or is moving) from a command economy to a market economy.

In Transition A developed economy, such as the United States (left), generally has greater access to technology than a transitional economy, such as China (right).

Less Developed Countries

Less developed countries (LDCs), such as many African, South American, and Eastern European countries, have a lower GDP, less well developed industry, and a lower standard of living. Often, these nations have ineffective or even outright corrupt governments that fail to protect private property rights. LDCs are sometimes called emerging economies, but some have emerged, so to speak, more than others. As a result, they can be divided into middle-income nations, such as Brazil and Thailand, and low-income nations, such as Mozambique and Cambodia.

The picture in the low-income nations is starkly different from what you see when you look around the United States. A high percentage of people live in substandard housing. Few families own televisions or washing machines. Even if they owned cars, there are few good roads to drive them on, since developing nations often lack infrastructure. **Infrastructure** is the basic set of support systems needed to keep an economy going. It includes such things as power, communications, transportation, water, sanitation, and education systems.

In these economies, a relatively high percentage of the people work at subsistence farming and have little savings. Often, even children toil with the rest of the family. Some go to school for only three or four years; some children receive no schooling. Health conditions are substandard, as medical care is hard to come by in rural areas. In many developing nations, political freedom is still a dream.

QUICK REFERENCE

A **less developed country** (LDC) has a lower GDP, less well developed industry, and a lower standard of living.

Infrastructure is the basic support systems needed to keep an economy going, including power, communications, transportation, water, sanitation, and education systems.

Economics Update

Find an update on health statistics in LDCs at **ClassZone.com**

APPLICATION Economies

A. What role does technology play in economic development?

Standards of Economic Development

KEY CONCEPTS

How is it possible to compare economies when each country may have its own ideas of what is valuable? For example, the number of television sets per thousand households yields valid information about the economic conditions in most nations. However, not every culture values television ownership to the same extent. Such statistics need to be used in conjunction with others, so that a more nuanced image of a nation's overall level of development can be obtained. Economists use the following standards of development to bring this detailed image into focus.

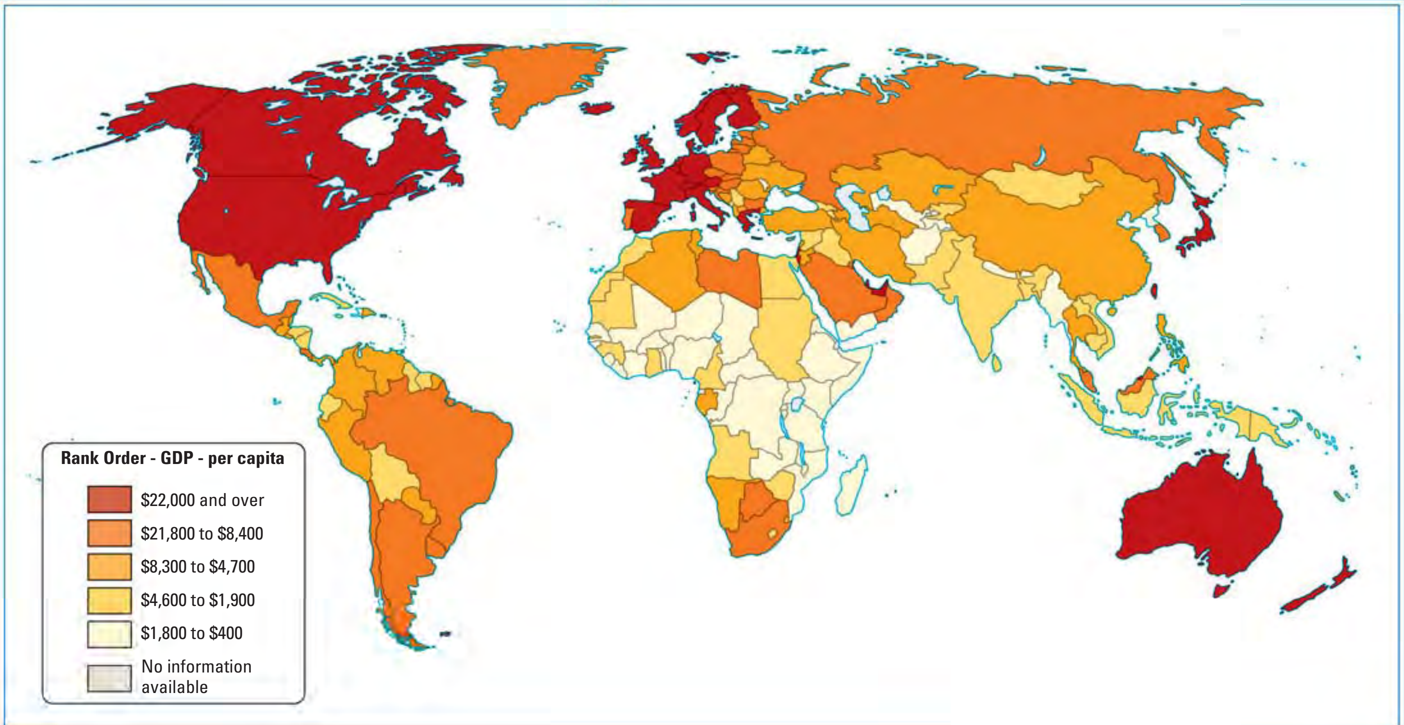
QUICK REFERENCE

Per capita gross domestic product is a nation's GDP divided by its total population.

Per Capita Gross Domestic Product

The most popular measure of economic development is **per capita gross domestic product**, a nation's overall GDP divided by its total population. This statistic is informative because it estimates the amount of goods and services produced per person in a given year. These figures can be used to compare one country to another. (See Figure 18.1.) For example, the per capita GDP of the United States is among the world's highest—over $40,000. In Tanzania, in east Africa, it is $700—among the lowest. Often these figures are adjusted to take into account the idea that a dollar may go further in some less developed countries where goods and services are less costly.

FIGURE 18.1 World Per Capita GDPs



ANALYZE MAPS

1. Which continent is the least developed?
2. Which continents have no countries in the top per capita GDP bracket?

Health

Statistics showing various aspects of health and health care are also useful in determining economic development. Especially indicative are statistics on the survival rate of babies. This measure is called the **infant mortality rate**, the number of children who die within the first year of life per 1,000 live births.

The infant mortality rate in Japan is 3. In China it is 23. In Angola it is 185. What can economists learn from these figures? The answer lies in understanding the conditions in which infants thrive. These conditions include a safe and sanitary birth environment with access to needed emergency care, adequate nutrition, an adequately fed mother who has access to clean drinking water and acceptable shelter, and protection from disease in the form of early-childhood vaccinations. A subsistence society, or one in extreme poverty, is unlikely to be able to provide these conditions. Less developed economies may be able to provide them to some degree, but in developed economies, these conditions are the norm.

Dangerous Water More than a billion people worldwide use unsafe drinking water sources. Disease and death can be real consequences of this fact.

Another useful standard is **life expectancy**, the average number of years a person could expect to live if current mortality trends were to continue for the rest of that person's life. For example, people born today in Japan can expect to live to age 82, in China, to age 72, while in Angola, only to age 39.

QUICK REFERENCE

Infant mortality rate is the number of children who die within the first year of life per 1,000 live births.

Life expectancy is the average number of years a person can expect to live if current mortality trends were to continue for the rest of that person's life.

Literacy rate is the percentage of people older than 15 who can read and write.

The **human development index** (HDI) uses targeted economic, education, and health statistics to assess a nation's level of development.

Education

The World Education Forum declares in its Framework for Action that "education is . . . the key to sustainable development and peace and stability within and among countries, and thus an indispensable means for effective participation in the societies and economies of the twenty-first century. . . ." Since education is so clearly tied into the economy, education statistics are tracked as useful indicators of the development level of a nation. One key education figure is the **literacy rate**, the percentage of people older than 15 who can read and write. Japan's literacy rate is 99 percent; Somalia's is 38 percent. Another useful statistic is student enrollment at all levels. This figure tells the percentage of school-age individuals who are actually going to school. In Belgium and Japan, for example, primary-school enrollment is 100 percent. In Niger, it is about 40 percent.

In 1990, another standard was introduced that combines some of these other statistics. It is the **human development index** (HDI)—the brainchild of Pakistani economist Mahbub ul Haq. A nation's HDI is a combination of its real GDP per capita, life expectancy, adult literacy rate, and student enrollment figures. Its measures are an important indicator of what life is like in a specific country.

Consumption of Goods and Services

In the mid-1990s, home appliances were still relatively rare in less developed countries like China. By the year 2000, however, the refrigerator had become a familiar part of Chinese city life; three out of four dwellings in major urban areas had one. Refrigerators have even begun to reach the secondary cities and rural areas, though they are still so rare there that they are sometimes displayed proudly in the living room rather than hidden away in the kitchen. Washing machines are also becoming increasingly commonplace. China's consumption of cell phones has risen rapidly in recent years too. At the beginning of 2001, there were approximately 65 million cell phones in use in China; by 2004, there were about 335 million—more than in any other country. The number of personal computers owned in China is doubling every 28 months.

What do these statistics say about China's economic development? These data show how people choose to spend their income after they have food and shelter. When consumption of such big-ticket items as refrigerators, automobiles, and washing machines increases, an economy is growing and developing. This indicates that people's living standards are rising. Goods that once were available only to the rich are now purchased by middle- and even low-income families.

In the less developed nations of China and India, 16 percent of the population is following this consumption pattern, compared with 89 percent of the population in Europe. The less developed nations therefore have the greatest room for growth in the consumption of consumer goods and services. For now, however, consumers in North America and Western Europe, whose population is about 12 percent of the global total, are responsible for 60 percent of the global total of consumption of goods and services. The 30 percent of the world population that lives in South Asia and sub-Saharan Africa, on the other hand, spends only 3.2 percent. Comparisons like the one below in Figure 18.2 offer another way to measure relative growth.

FIGURE 18.2 Ownership of Typical Consumer Goods

(per thousand residents)

Country	Television Sets	Telephone Mainlines
United States	835	659
Ukraine	456	212
India	83	40

Source: The State of the World, 2004

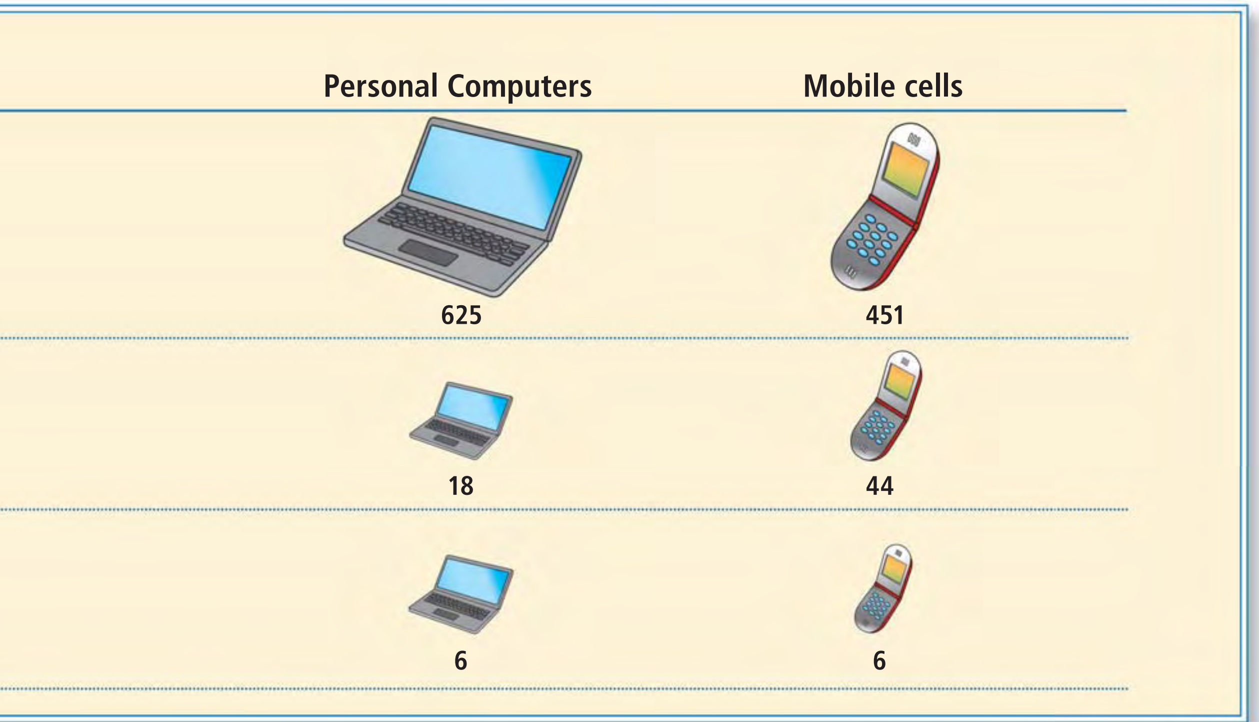
Energy Use

Of the roughly 6.5 billion people in the world, as many as 2 billion are without electricity. Since electricity and other forms of energy contribute to economic development, statistics on energy use can reveal an aspect of a nation's economic development. Energy use is not spread evenly throughout the population. Asia, with 50 percent of the world's people, accounts for just over 21 percent of annual energy consumption. For another example, the average global consumption of electricity is 2,744 kilowatt hours (KWh) per capita. Japan's annual per capita consumption of electricity, like that of other industrialized nations, is well over 7,000 KWhs. Colombia's annual rate of about 820 KWh per capita is typical of LDCs, which average about 750 KWh per capita each year.

Wind Power Wind farms, such as this one in northwest China, contribute a small but growing part of the world's electricity.

How the energy is put to use is another revealing statistic, especially the amount used for commercial purposes. The United States, for example, uses the equivalent energy of 8,148 kilograms of oil per person in commercial enterprises. India uses the equivalent of about 494 kilograms of oil per person for commercial activities. The amount of energy used for commercial purposes correlates to a nation's level of technological achievement and other economic measures.

Projected energy use to the year 2025 follows the same pattern as the projected consumption of consumer goods and services, with LDCs outpacing developed nations. The LDCs are expected to increase their energy use by about 3.2 percent a year. In Asia, including China and India, the demand for energy is expected to double between 2002 and 2025. The relatively rapid increase in energy use coincides with the move toward industrialization and technological advances. In fact, transportation and industry account for nearly all of the projected increase in the use of fossil fuels.



In contrast, the developed nations are projected to increase their energy use by only 1.1 percent a year. Developed economies use fuel more efficiently, which accounts in part for their slower rate of increase in energy use. Transitional economies are expected to increase their energy use by 1.6 percent each year as they face the challenges of moving to a market economy.

Labor Force

In what kind of job do most of a nation's workers find themselves employed? The answer to this question reveals one aspect of a nation's level of development. According to the World Bank, this measure includes all the economically active people between the ages of 15 and 65 in a country—including the employed, the unemployed, and soldiers, but excluding students and unpaid caregivers. The fewer workers there are engaged in agriculture, and the greater the number of workers in manufacturing and service industries, the more developed the nation.

A GLOBAL PERSPECTIVE

Botswana's Growing Economy

Since it became independent in 1966, Botswana's per capita income growth has been among the fastest of any nation in the world. This small African country transformed itself from one of the world's poorest countries to a middle-income nation in under 50 years. In 2004, Botswana received an A credit rating from Moody's and from Standard and Poor's.

Botswana has succeeded largely by maintaining a stable and responsible governmental system. The government has managed the income from large-scale mining operations wisely, reinvesting it in the nation's physical and human infrastructure. In recent years, the development of the financial services and tourism industries has been stressed. Together, they now represent about one-quarter of the nation's GDP.

Botswana still faces a number of social and economic challenges, including high unemployment, low manufacturing output, and one of the world's highest rates of HIV/AIDS infection. But through its moves to diversify the economy, the government has put the nation on a solid development track.

CONNECTING ACROSS THE GLOBE

1. How has the government of Botswana helped keep the nation's economy growing?
2. In the article, what tells investors that Botswana is a relatively safe place to invest?

APPLICATION Drawing Conclusions

B. Would you expect a positive or negative correlation between literacy rates and infant mortality rates? Explain.

SECTION 1 Assessment

Online Quiz
ClassZone.com

REVIEWING KEY CONCEPTS

1. Explain the relationship between the terms in each of these pairs:
   a. *developed nations*
      less developed countries
   b. *human development index*
      infant mortality rate
2. What does the state of a nation's infrastructure say about the country's level of economic development?
3. Why is per capita GDP a more useful statistic than overall GDP when comparing nations?
4. What does an analysis of the labor force and energy usage tell economists about a nation?
5. Why are health and longevity statistics useful in determining a nation's level of development?
6. **Using Your Notes** Pick one example of a developed nation, one of a transitional economy, and one of a less developed nation. Use your notes to explain why you chose each.

   Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

Definitions of Development

Levels of Development	Standards of Economic Development

CRITICAL THINKING

7. **Comparing and Contrasting** Compare and contrast three characteristics of a developed nation and a less developed nation.
8. **Making Inferences and Drawing Conclusions** One measure of economic development is the extent to which a nation buys big-ticket consumer goods. Does the production of those goods also indicate a level of economic development? Explain your answer.
9. **Writing About Economics** Some economists argue that GDP does not give an accurate picture of a nation's well-being. They point out that GDP reflects economic activity that pollutes the environment and depletes resources as well as economic activity that counteracts the pollution. In other words, it shows both the polluting enterprises and the cost of cleaning up the pollution on the plus side of the balance sheet. Write a paragraph speculating on how to revise GDP figures to reflect this concern.
10. **Challenge** In poorer countries, where does the money for development initiatives come from?

ECONOMICS IN PRACTICE

Health care in Bangladesh

Understanding Levels of Development

The chart below shows life expectancy, infant mortality rates, and literacy rates for five countries.

Country	Life Expectancy (years)	Infant Mortality (per 1,000 live births)	Literacy Rate (%)
Bolivia	65.8	51.8	87.2
Germany	78.8	4.1	99.0
Moldova	65.7	38.4	99.1
Philippines	70.2	22.8	92.6
Bangladesh	62.5	60.8	43.1

Source: *CIA World Factbook, 2006*

Drawing Conclusions Which nation is probably the most developed? Which nation is probably the least developed? Which nation is more developed, Bolivia or the Philippines? Explain your answers.

Challenge If you were "weighting" the various measures used to show economic development, which would you consider most meaningful: life expectancy, infant mortality, or literacy rate? Explain your answer.

SECTION 2

A Framework for Economic Development Objectives

OBJECTIVES

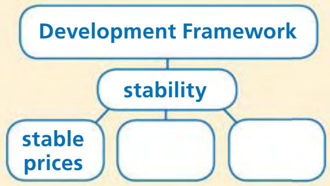
In Section 2 you will
- evaluate the importance of developing human and physical capital
- examine the importance of stability and opportunity in economic development
- describe how developing nations raise money for development programs

KEY TERMS

capital flight, *p. 558*
default, *p. 559*
World Bank, *p. 559*
International Monetary Fund (IMF), *p. 559*
debt restructuring, *p. 559*
stabilization program, *p. 559*

TAKING NOTES

As you read Section 2, complete a cluster diagram like the one shown for each major concept. Include key concepts and other helpful words and phrases. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**



Resources

KEY CONCEPTS

What does a nation need to develop economically? Natural resources such as minerals and fossil fuels play a role in economic development. A nation's climate and the amount of land suited for agriculture are also factors. Each nation uses the resources it has. However, natural resources are not enough. Investing in human capital and physical capital, for example, are ways that many nations promote economic expansion.

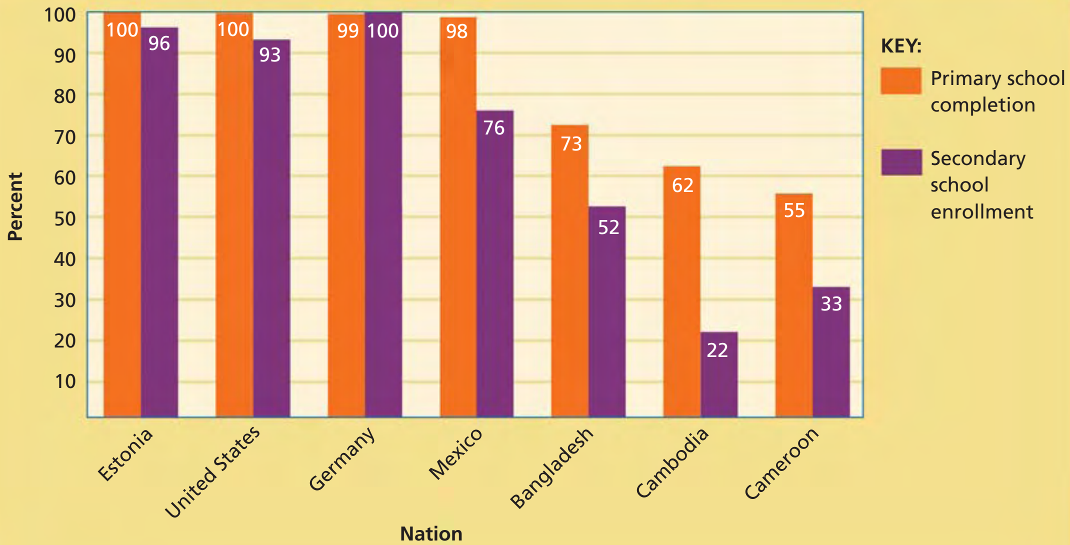
High Levels of Human Capital

People are the most valuable resources in a market economy. One element of a healthy and growing market economy is a commitment to make the most of its human resources through education and training. Education and training help people develop the skills to enter into and function productively in the economy.

Human Capital Societies benefit in many ways when their citizens are well educated.

Investing in education also affects other aspects of a society. Educated citizens are able to make informed decisions about health matters. Educated parents are likely to vaccinate their children and invest in their children's education. Furthermore, educated citizens are likely to vote, participate in civic affairs, rise above poverty, and avoid criminal activity.

FIGURE 18.3 RATES OF PRIMARY SCHOOL COMPLETION AND SECONDARY SCHOOL ENROLLMENT



Source: World Development Indicators, World Bank Group, 2002

ANALYZE GRAPHS

1. What nation shows the largest drop-off between the percentage of students that complete primary school and the percentage who go on to secondary school?
2. Do you think the amount of drop-off between education levels is a clue to a nation's level of development? Explain your answer.

High Levels of Physical Capital

Physical capital is also an important factor contributing to economic growth. As you read in Chapter 1, physical capital consists of the human-made goods—machines—that are used in the production of other goods and services. Investments in physical capital make people more productive.

Fortunately, LDCs do not have to reinvent the wheel. Technology and other innovative capital resources are always being refined in developed nations. LDCs need only copy or import the technology. The desire to copy or import technologies points to the link between human and physical capital. Copying technology requires educated and well-trained people. Importing technology requires money, which is generally in short supply in LDCs, so these nations look to foreign investment. However, a country that lacks human capital is less attractive to investors that might supply this money.

APPLICATION Explaining an Economic Concept

A. Think of your own examples to explain the ripple effect that education has on a society and economy.

Stability

KEY CONCEPTS

While such inputs as human capital and physical capital are necessary for increased output, they are only part of the framework for economic growth. The overall governmental and economic environments must be stable enough to support growth before those inputs can best be put to use.

Effective Government Institutions

In the United States, the rule of law is so fundamentally a part of the culture that it may be taken for granted. We are used to laws made by a legislature that we elect according to the principles laid out in the Constitution. We take for granted that the laws will then be made public for all to know and follow. We expect those laws to be applied fairly. When there are disputes, we trust that our legal system will sort out the differences according to the law, not by bribery or intimidation.

In many countries, however, the rule of law is still out of reach, and in those places, economic growth suffers. Business investment always carries risk, even in a nation with effective government institutions. That risk rises sharply in countries where the enforcement of laws is unpredictable, where private property rights are unprotected, where a bureaucracy is corrupt or bloated or both, and where judges can be bought and sold. The rule of law provides a foundation of predictability and certainty that reduces economic risk.

Democracy itself is a key factor of economic growth. Democratic nations have a higher rate of economic growth than nations with a different form of government. In nations where people can choose their representatives in free and open elections, they can promote their economic self-interest with the same degree of power as other citizens. When the press is uncensored, views that oppose government policy can be aired and debated. In a famous study, one Nobel Prize–winning economist, Amartya Sen, concluded that crop failures are not the chief cause of famines: political systems are. He points out that no widespread famine has ever occurred in a democratic nation. India has had famines, but none since it became a democracy in 1947. The democratic process reduces the likelihood that the government will interfere with the self-correcting market forces that could prevent widespread famine.

Law Enforcement A fair and transparent court system is key to the kind of governmental stability that promotes development.

Stable Prices

In areas where prices are stable and where the governments' fiscal and monetary policies are sound, economic growth can take root. Investors in such an environment know what to expect. They do not see volatile changes in interest rates, prices, or the level of the government debt.

With price stability, businesses can make long-term plans with some assurance that conditions will not change too dramatically and that the government will not go bankrupt. In contrast, in nations with a high inflation rate or with unstable interest rates, investors run a high risk. Many will choose to avoid investing in such an environment in the first place. And even if they do take a chance, they are likely to withdraw their investment at the first sign of trouble. That leaves the unstable country further behind, since the funds it could use for economic expansion are placed in more stable nations.

Monetary Stability Runaway prices in post–World War I Germany made money into children's toys (left). A stable currency and stable prices create real purchasing power (right).

Protected Property Rights

Guaranteed protection of private property provides an incentive for economies to grow. If businesses have no way to assert ownership of their enterprises, they will have little incentive to take economic risks, since they will have no guarantee of reaping the rewards if they succeed. Assured property rights give investors confidence and stimulate entrepreneurship.

Business owners also need private property rights to prevent the government from interfering with or restricting their operations. In such unstable nations as Haiti, Kazakhstan, and Indonesia, where corruption and favoritism are widespread, private property rights are insecure. This lack of stability is more than enough to cause investors to look elsewhere to locate their enterprises.

In some LDCs, especially former colonies of Western nations, land ownership is in the hands of a very small percentage of the population—usually the descendants of the colonists. In some cases, this land is seized by the government for redistribution to the majority population. Foreign investors are wary of locating businesses in countries that threaten private property.

APPLICATION Drawing Conclusions

B. Why is the rule of law a stabilizing force that promotes development?

Opportunity

KEY CONCEPTS

Economic opportunity depends on a number of functions that fall to the government. These include opening international trade, helping people move up the income ladder, controlling corruption, and limiting regulations.

Open International Trade

The government can also create opportunities for economic growth by lowering restrictions on international trade. As you read in Chapter 17, trade benefits the trading nations by allowing them to produce what they are most efficient at producing and trading for the rest. Partners in a trading relationship produce more than they would without trade, leading to economic growth.

However, in less developed countries, governments have imposed high tariffs on imports and instituted other protectionist measures in an effort to give local producers an advantage. Governments often justify these protections as a short-term effort to help local industries until they grow strong enough to compete with foreign competitors. Protectionist measures come with costs, though. Consumers have to pay more for goods than they would in a market open to imports. Also, government protections may reduce incentives for producers to become more efficient. Industries may become dependent on tariffs and other trade barriers.

Increase Social and Economic Mobility

Economic opportunity leads to the most vigorous economic growth when that opportunity is open to the entire population. If all citizens have an equal opportunity under the law to engage in economic enterprise, many will be motivated to lift themselves into a higher income bracket. A number of studies have found that in the United States, for example, about 25 to 33 percent of the population moves into a new income quintile each year. Over a ten-year period, that number rises to 60 percent. In the process of seeking personal economic reward, these people are also helping the economy to grow.

In some traditional cultures, however, social conditions do not promote equal opportunity. For example, in some LDCs with a traditional culture, the lower status of women keeps half the labor force from developing its full potential. Further, an entrenched class structure in some nations hampers growth, since the rich do not want changes that could deprive them of their wealth. Governmental changes that promote equal opportunity will help create a successful framework for economic growth.

Economic Potential In many traditional societies, women are an untapped resource that could give development a boost.

Economics Update

Find an update on women in the workplace in LDCs at **ClassZone.com**

Control Corruption

Corruption, the abuse of public office for private gain, is an especially urgent problem that helps explain why some nations are able to develop and others are not. When government officials are at liberty to enrich themselves and others—by taking bribes and kickbacks, funneling lucrative government jobs and contracts to relatives and allies, skimming aid and loan money, and so on—the rest of the nation, especially the poor, pays the price. (See Figure 18.4.) Although there is not an exact correlation between corruption and per capita GDP, much more often than not, countries with less corruption have higher per capita GDPs.

FIGURE 18.4 Corruption and Per Capita GDP

Country	Corruption Index*	Per Capita GDP (in U.S. dollars)
Finland	9.6	31,000
Australia	8.7	31,600
Chile	7.3	11,900
United States	7.3	41,600
Slovenia	6.4	21,500
Bhutan	6.0	1,400
South Korea	5.1	22,600
South Africa	4.6	12,200
Turkey	3.8	8,400
Bolivia	2.7	2,900
Uganda	2.7	1,800
Albania	2.6	5,300
Russia	2.5	11,000
Kyrgyzstan	2.2	2,000
Cambodia	2.1	2,500

*10=least corrupt; 0=most corrupt
Sources: Transparency International; CIA World Factbook; 2006 and earlier data

Limit Regulation

Governments with reasonable tax levels and business regulations help to create economic opportunity. Businesses and other investors are more likely to be attracted to nations with relatively little "red tape."

Even in the United States, which has relatively few regulations on business, it is estimated that companies with 20 or fewer employees have to pay over $7,500 per employee each year to comply with government regulations. In many LDCs, the number of regulations is significantly higher. In a climate of instability, the high number of regulations can lead to corruption. Rather than comply with all the regulations, businesses are tempted to bypass them through payoffs. As you have read, a corrupt environment removes economic incentive and slows economic growth.

APPLICATION Applying Economic Concepts

C. Nations with the highest corruption index tend to have their wealth distributed less evenly, with a large percentage of people living in poverty. Why might this be so?

Financing Development

KEY CONCEPTS

Nations seeking to finance economic development can look to four main sources: internal investment, foreign investment, aid from foreign governments, or investments from international agencies. A developing nation must consider both the positive and negative aspects of each source.

Internal Investment

Investment funds for economic development can come from both public and private internal investment. Banks within the nation invest in economic enterprises, such as roads, bridges, and other infrastructure. Egypt, for example, has a goal to make domestic savings the key force in development and has been working toward increasing the savings rate to 25 percent of GDP. To do so, it has an initiative to bolster the insurance industry, which is successful at pooling and channeling savings.

In poorer nations, personal savings are very low, so banks have little to invest. Compounding the problem, the wealthy citizens of these countries sometimes invest their funds in developed countries rather than their own country, a problem known as **capital flight**. If private banks lack the funds to invest, the country's government may provide funds. It might also seek foreign investment from multinational corporations of through sales of government bonds.

QUICK REFERENCE

Capital flight occurs when capital from a country is invested outside that country.

Foreign Investment

There are several ways in which foreign interests can invest in an economy. One is foreign direct investment (FDI), the establishment of a business enterprise in a foreign country. A second is foreign portfolio investment, through which foreign investors take part in a nation's stock and other financial markets. Foreign investment in less developed countries increased from $44 billion in 1990 to $226 billion in 2000. One reason for the increase is that less developed nations had created a more attractive business climate for investors. Multinationals that open manufacturing plants in foreign nations provide jobs and training to the local population and reap the benefits of cheaper labor.

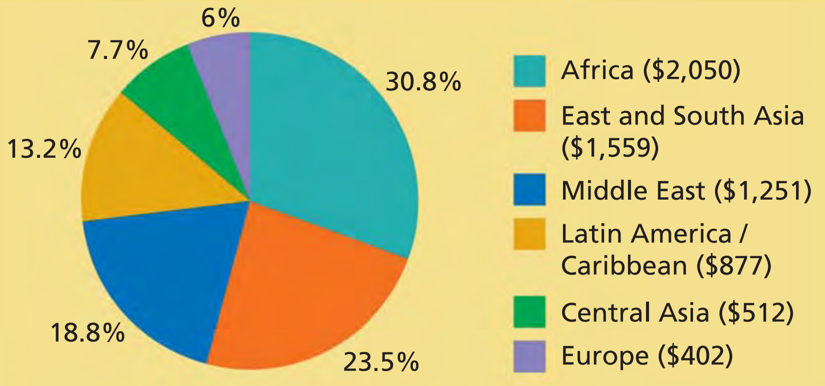
Foreign Direct Investment Multinational corporations bring employment, training, and new technology to less developed countries. This factory in Beijing is a joint venture between a Chinese company and DaimlerChrysler.

Loans and Aid

Developing nations have also turned to loans to help finance their economic development. External debt, money borrowed from foreign banks or governments, has become an issue of great concern in some LDCs. Some countries, especially in South America and Africa, have more debt than they can pay back. When a nation cannot pay interest or principle on a loan, it is said to be in **default**.

Nations may also seek foreign aid—money from other nations. (See Figure 18.5 for aid figures from the U.S. Agency for International Development [USAID]).

FIGURE 18.5 USAID ALLOCATIONS BY REGION



Source: U.S. Agency for International Development, 2006

International Help Agencies

LDCs also receive aid from several important international organizations. The World Bank, the International Monetary Fund, and the United Nations Development Program are the main international organizations devoted to economic development.

- **World Bank** is a financial institution that provides loans, policy advice, and technical assistance to low- and middle-income countries to reduce poverty.
- **International Monetary Fund (IMF)** is an international organization established to promote international monetary cooperation, foster economic growth, and provide temporary financial assistance to countries to help ease balance of payments adjustment. The IMF helps nations overloaded with debt to develop **debt restructuring**, a method used by countries with outstanding debt obligations to alter the terms of the debt agreements in order to achieve some advantage. It often oversees **stabilization programs**, in which it requires these troubled nations to carry out reforms—reducing foreign trade deficits and external debt, eliminating price controls, closing inefficient public enterprises, and slashing budget deficits.
- **United Nations Development Program** (UNDP) is a United Nations agency working to fight poverty. In 2006 it had active programs in 174 nations.

APPLICATION Making Inferences and Drawing Conclusions

D. Why would Kuwait, a developing nation, offer aid to countries in its region?

QUICK REFERENCE

Default is when a nation cannot pay interest or principle on a loan

The **World Bank** is a financial institution that provides loans, policy advice, and technical assistance to low- and middle-income countries to reduce poverty.

The **International Monetary Fund (IMF)** promotes international monetary cooperation, fosters economic growth, and provides temporary financial assistance to countries to help ease balance of payments adjustment.

Debt restructuring is a method used by countries to alter the terms of their debt agreements in order to achieve some advantage.

A **stabilization program** is a required program of reforms imposed by the IMF to steady the economy of a debtor nation in danger of default.

ECONOMICS PACESETTER

Anne Krueger: Reforming IMF Development Policy

On September 1, 2001, Anne Krueger became First Deputy Director of the International Monetary Fund. Ten days later, the terrorist attacks on the United States sent shockwaves through the global economy. Three months later, Argentina suspended payments on its $132 billion foreign debt. At the time, this was the biggest default in history. All the while, there were significant economic upheavals as well as international protests over the burden of debt in developing nations. Clearly, she didn't have the luxury of easing into her new position.

A New Role for IMF

Luckily, Krueger came very well prepared for her new job. In addition to her professorships at Stanford University, Duke University, and the University of Minnesota, Krueger had also been Director of the Center for Research on Economic Development and Policy Reform, at Stanford, and the Vice President of Economics and Research at the World Bank.

In November 2001, anticipating Argentina's default, Krueger put forward a proposal for the role of the IMF in debt restructuring and dispute resolution. In her proposal, the IMF would oversee the restructuring of the debt rather than simply providing bailout funds. The reform effort also called for collective action clauses, measures that let a supermajority of creditors overrule a creditor who is holding out for more repayment than may be possible. In fact, after several years of negotiations, most of Argentina's creditors accepted 35 cents on the dollar in early 2005, and Argentina's credit rating climbed once again.

Even 35 cents on the dollar, however, seems too high to many critics, who believe that debt in most developing nations should be forgiven 100 percent so the money used to service the debt can be put to use providing such needed human services as health care and education. Krueger has disagreed: ". . . Unless there is radical change from past behavior on the part of the debtors, their priorities for the use of released resources are not likely to be on education, health, or other expenditures that will enable the poor to improve their lot." Nonetheless, the IMF is part of a plan to forgive debt completely in 18 of the most heavily indebted poor nations in exchange for economic policies that favor trade liberalization and other development goals.

Anne Krueger

FAST FACTS

Anne O. Krueger

Title: First Deputy Managing Director of the IMF, September 2001 to August 2006

Born: February 12, 1934, New York City

Major Publications Edited:

Reforming India's Economic, Financial, and Fiscal Policies. Edited with Sajjid Z. Chinoy, 2003

Latin American Macroeconomic Reform: The Second Stage. Edited with Jose Antonion Gonzales, Vittorio Corbo, and Aaron Tornell, 2003

Selected Awards:

- Distinguished Fellow and past President of the American Economic Association
- Frank E. Seidman Distinguished Award in political economy (1993)
- Bernard Harms Prize awarded by the Kiel Institute of World Economics (1990)

Economics Update

Find an update on Anne Krueger at **ClassZone.com**

APPLICATION Solving Economic Problems

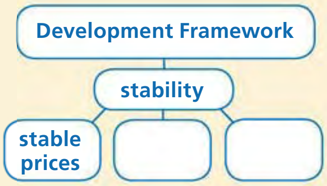
C. Krueger believes that direct aid to nongovernmental organizations working in health or education are more effective than debt cancellation. Critics argue that grants with conditions show the IMFs desire to control nations' economies. Who do you agree with? Give reasons for your answers.

SECTION 2 Assessment

Online Quiz
ClassZone.com

REVIEWING KEY CONCEPTS

1. Explain the relationship between this pair of terms:
   a. *International Monetary Fund*
   b. *stabilization program*
2. What are four key sources of funding for development?
3. How can a nation develop its human capital?
4. How can a nation improve its business climate?
5. What roles do foreign nations play in a country's development?
6. **Using Your Notes** Use your completed cluster diagram to help you explain how the economic development of one nation might be an opportunity for growth for another nation. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**



CRITICAL THINKING

7. **Analyzing Cause and Effect** How might the bailout by an international agency of a nation that has defaulted on foreign debt lead to more corruption in the future?
8. **Writing About Economics** Many economists believe that a country that is rich in a particular natural resource may actually be at a developmental disadvantage. They point out that nations such as these tend to put all of their resources into this one industry. Write a paragraph about how you, as leader of a nation, would use the large income from your nation's natural resource to take other avenues to developing your economy.
9. **Applying Economic Concepts** Look again at Figure 18.5. The United States grants aid money each year to nations in the developing world. Do you think Anne Krueger would think this aid money should come with certain terms or conditions? Explain.
10. **Challenge** If you were in charge of development efforts for a poor nation, which source of development funds would you focus on? Why?

ECONOMICS IN PRACTICE

Understanding the Path to Development

Read the following scenarios of fictional less developed countries:

- In nation A, there is a democratically elected government, but a corrupt law enforcement system has made property rights shaky. There is little foreign trade, and few foreign firms have set up manufacturing facilities. However, a foreign nation gives nation A hundreds of millions of dollars in aid each year.
- In nation B, the move toward democracy has begun. A system of fair and transparent law enforcement is in place, and international trade and foreign direct investment are on the rise. High levels of foreign debt, however, could pose a problem in the future.

Categorizing Economic Information Is nation A or nation B more likely on a path to successful development? Explain why you think so.

Challenge What's more beneficial to development— a connection to a large amount of foreign aid money or a plan to increase social, political, and economic stability? Why?

SECTION 3

Transition to a Market Economy

OBJECTIVES

In Section 3 you will

- identify problems that emerge when an economy goes from command to market
- describe the transitions to a market economy in the former Soviet Union and nations it dominated
- discuss the transitions to a market economy in China

KEY TERMS

privatization, *p. 563*
shock therapy, *p. 563*
perestroika, *p. 564*
special economic zone (SEZ), *p. 567*

TAKING NOTES

As you read Section 3, complete a cluster diagram like the one shown, using the key concepts and other helpful words and phrases. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

New Challenges

KEY CONCEPTS

In Chapter 2, you read about different economic systems, including a command, or centrally planned, economy in which all economic decisions are made by the society's leaders, usually government officials acting in a central location. For a while, much of the world's population lived in a command economy. However, China, the nations that formerly made up the Soviet Union, and many Eastern European countries have taken steps toward a market economy. The transition requires new answers to the basic economic questions that central planners used to answer. Both the government and private individuals and companies face a number of challenges.

CHALLENGE 1 Poor Infrastructure

A market economy needs a solid infrastructure to facilitate the production and distribution of goods and services. In a command economy, transportation, communications, banking, and education—the infrastructure of an industrialized nation—are as inefficient as other industries tend to be. With no competition there is little incentive to create a more robust physical and institutional infrastructure. Modernized airports, phone systems, roads, harbors, bridges, and computer connections help a transitional economy support and spread the goods and services it produces.

Bridging the Gap Transportation infrastructure is vital to develop a successful market economy.

CHALLENGE 2 Privatization

Under communism, the government owns all property. As transitional nations move toward a market economy, they have all undertaken the challenges of **privatization**, the process of transferring state owned-property and businesses to individuals. A major problem with privatization is how to sell the property. It can, for example, be auctioned off, but command economies have little private savings, and few people have the needed finances. Also, as you'll read later, these auctions can sometimes be rigged to benefit those close to the ruling elites. A second method is to sell shares of businesses through a vehicle like the stock market. A third way is to give vouchers to people to purchase shares of a business, making cash unnecessary.

QUICK REFERENCE

Privatization is the process of transferring state owned property and businesses to individuals.

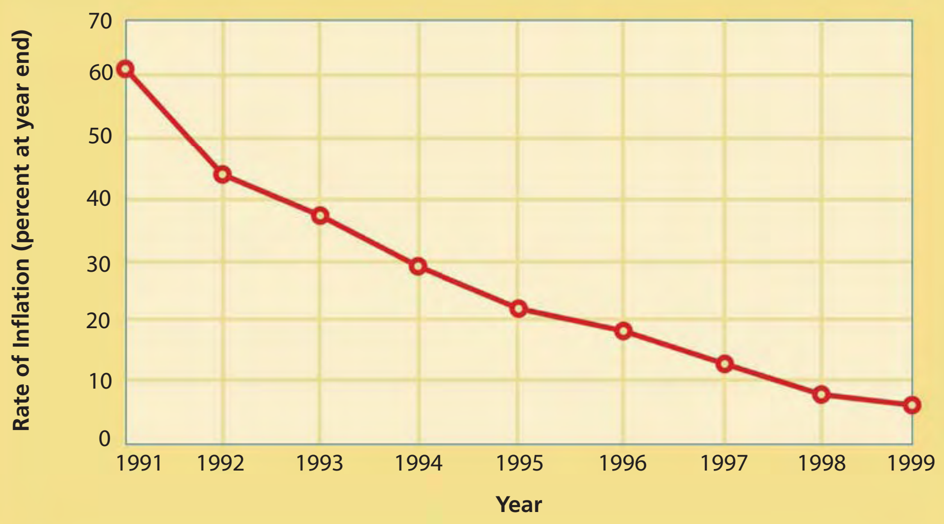
CHALLENGE 3 Rise in Prices

In a command economy, some goods may have artificially low prices. Part of the switch to a market economy is the removal of price controls, allowing the market to operate. On January 1, 1990, Poland's government gave the go-ahead for an economic program referred to as **shock therapy,** involving the abrupt shift from a command to a free-market economy. The initial result indeed shocked consumers; the inflation rate that first month was 78 percent. However, this inflationary "correction" eased as the free-market policies were allowed to take hold. (See Figure 18.6.)

QUICK REFERENCE

Shock therapy is an economic program involving the abrupt shift from a command economy to a free-market economy.

FIGURE 18.6 POLAND'S INFLATION RATE AFTER SHOCK THERAPY



Source: "The Polish Zloty 1990–1999: Success and Under-Performance," Dominico Nuti

ANALYZE GRAPHS

1. After 1991, how many years did it take Poland to cut its inflation rate in half?
2. Why did the inflation rate consistently decrease after the initial "shock" of 1991?

APPLICATION Making Inferences and Drawing Conclusions

A. Which of the challenges above do you think is the most serious? Give reasons for your answer.

Economic Change in the Former Soviet Bloc

QUICK REFERENCE

Perestroika was a gradual plan to incorporate markets into the Soviet Union's command economy.

KEY CONCEPTS

In the 1980s, Soviet leader Mikhail Gorbachev introduced **perestroika**, a plan to gradually incorporate markets into the Soviet Union's command economy. People began to push for political freedom as well, and in 1991 the Soviet Union dissolved. The collapse of the Soviet Union caused a period of dramatic transition throughout Eastern Europe and Central Asia.

EXAMPLE 1 Russia

The transition has been a turbulent time for Russia. Like Poland and several other Eastern European nations, it pursued a program of economic "shock therapy." The resulting inflation was devastating. Supplies of goods were very low, and many industries were forced into bankruptcy when faced with the need to become "self-financing." Further, the state was poorly equipped to carry out even the most basic functions of government, such as tax collection. As a result, with little revenue to work with, it could not offer welfare services to cover the disruptions of the economic shift, and the burden of government debt began to rise.

Amid the upheaval, some market forces began to exert themselves. Without directives from central planners, regional business initiatives could address the real demands of consumers. In 1992, a program of privatization began to put the means of production into private ownership, introducing incentives for success.

The privatization process, however, was fixed in favor of certain individuals. As a result, a small group of politically well-connected business people snapped up many of Russia's former public assets through a series of rigged auctions. These oligarchs, as they're known, went on to build massive corporations and became the most powerful economic force in modern Russia.

The best-known oligarch, Mikhail Khodorkovsky, has recently been sentenced to nine years in prison on fraud and tax evasion charges. In addition, his giant oil company, Yukos, was taken over by the government. It is widely believed that the charges against him were motivated by his support for political parties that were opposed to Russia's president, Vladimir Putin. Many saw this case and others as symptoms of Putin's reluctance to truly adopt democratic reforms and a market economy. Taken together, Putin's actions, the power of Russian organized crime, and the persistence of widespread corruption threatened to undermine Russia's successful development.

At Will Oligarchs? The prosecution of Khodorkovsky was seen by many as a warning to Russia's oligarchs: the price of opposition to Putin's government may be your freedom.

EXAMPLE 2 Former Soviet Republics

The transition of the former Soviet Republics has been varied. The Baltic Republics—Latvia, Lithuania, and Estonia—have fared better than others, experiencing a 45 percent inflation rate while Ukraine had a 400 percent rate and Kazakhstan in Central Asia had a rate higher than 1,000 percent. Of all the former republics, only the Baltic Republics, Armenia, Belarus, and Kazakhstan have a higher output now than they did before the collapse of the Soviet Union. Nevertheless, many economists believe the quality of goods and services produced is higher. In the other republics, poor infrastructure, complicated bureaucracies, undeveloped property laws, and corruption have interfered with economic growth.

Vilnius Since independence, the capital of Lithuania has thrived. It accounts for one-third of the nation's GDP and attracted 2.815 billion euros in FDI in 2005.

EXAMPLE 3 Eastern Europe

The formerly Communist nations of Eastern European have faced some of the same challenges as their neighbors and had similarly varying degrees of success. The largest nations, the Czech Republic, Hungary, and Poland, are now much like Western countries. They are members of the European Union, but some experts believe they will need until 2035 to catch up economically with other member nations. Nonetheless, progress is apparent. Since the transition, Poland's economy has been growing at an average rate of 6 percent annually, industrial productivity has increased by more than 20 percent, and the private sector is responsible for more than 70 percent of the national income. There are more than 2.5 million small- or medium-sized businesses operating today, and Western franchises, such as the McDonald Corporation and the IKEA Group, have become entrenched.

However, Poland also has problems that are common across the nations of Eastern Europe. Its infrastructure is out of date, and telephone and internet services are very costly. The laws for registering to do business in the Polish market are confusing, and the patent process that protects property rights is slow. The health care and pension systems have weakened, and unemployment is high. Averaged throughout the country, the unemployment rate is about 18 percent, but in some regions it is as high as 40 percent, and workers are discouraged. In Hungary, the illegal "hidden economy" may account for up to 30 percent of GDP.

APPLICATION Comparing and Contrasting Economic Information

B. Which of the three regions—Russia, the former Soviet Republics, or Eastern European nations—has had the hardest transition? Explain your answer.

China Moves Toward a Market Economy

KEY CONCEPTS

China became a Communist country in 1949, but it began a transition to a free market economy in 1978. At that time, its leader, Deng Xiaoping, introduced free market economic principles to stimulate China's economy. The result was a vastly changed and rapidly growing economy.

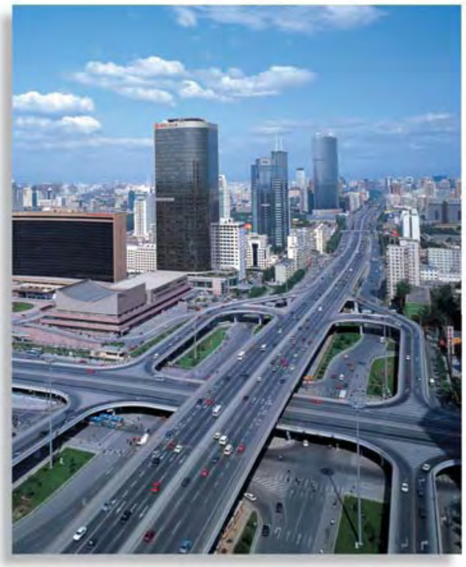
EXAMPLE Rapid but Uneven Growth

In the early years of China's Communist economy, central planners focused on redistributing land, developing heavy industry, and improving China's transportation system. In 1958, the government introduced the Great Leap Forward. This plan focused on the building of huge collective farms and the development of the steel industry. For a while, both agricultural and steel output increased. However, the gains were short-lived. Poor economic planning and a series of natural disasters led to stark times. Millions of people died in famines.

When Deng Xiaoping came to power in the late 1970s, hundreds of millions of Chinese villagers lived in poverty, sometimes sharing one pair of trousers among a whole family. Deng brought hope and practical programs to the people. "It is time to prosper. . . . To get rich is glorious," he said. Deng began a far-reaching but gradual program to relax government control over the economy and let market forces drive economic growth.

In agriculture, farmland that had been confiscated was returned to the farmers in household units. Under this "household responsibility system," farms still had to supply a quota of staple goods to the government at set prices, but beyond that the farmers could grow what they wanted and sell any surplus on the open market. China reported a ten percent annual growth in agricultural output between 1979 and 1984. Brick homes began to replace thatched huts as farmers' income soared.

A Growing Divide
Modernization has come at breakneck speed in many of China's urban centers, while life in rural China can seem to be in a different century.



In the mid-1980s, Deng focused his reform effort on industry, where two-thirds of the manufacturing plants were still state-owned. Deng moved slowly and cautiously. Instead of privatizing suddenly or making drastic, uniform changes, he scattered the reforms among different industries. In one industry, local managers might have more decision-making power. In another, workers might get raises based on the profits of the factory. Deng's reforms also called for localities to invest in the industries they thought would thrive. In this process, resources were re-allocated from heavy to light industry, a key factor in China's rapid growth.

Deng also created **special economic zones (SEZs)**, regions that have economic laws that are different from a country's usual economic laws, with the goal of increasing foreign investment. The first four were begun in 1979 as an experiment. In 1984, fourteen more were created in cities along the coast, including Shanghai; now there are hundreds. The SEZs have tax incentives for foreign investment, and the economic activities are driven entirely by market forces. Further, when capitalist Hong Kong was returned to China in 1997 after a 99-year lease by the United Kingdom, it was reunified under the "one country, two systems" framework. The government did not interfere with its economy; in fact, it became a model for the nation.

Areas with high foreign investment have raced ahead of other parts of the country economically, contributing to China's annual growth in GDP of between 5 and 15 percent since the reforms began. Some people, encouraged by Deng's proclamation, have become very rich. However, in 2003, the number of people living in extreme poverty (on less than $77 a year) rose for the first time in 25 years, to about 3 percent of the population. In some villages of western China, 90 percent of the people live on government welfare and do not have indoor plumbing or telephones.

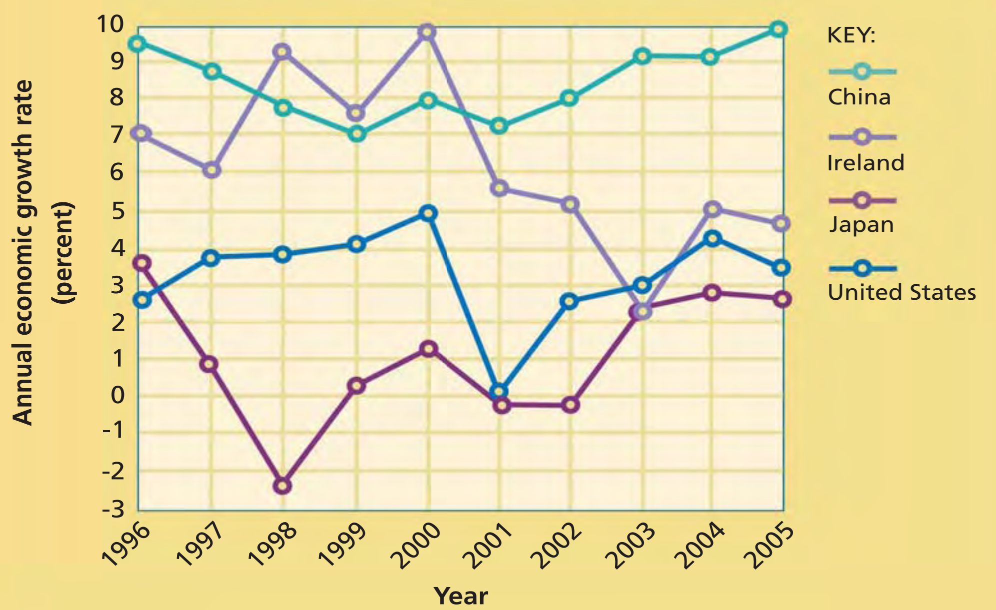
QUICK REFERENCE

A **special economic zone (SEZ)** is a geographical region that has economic laws that are different from a country's usual economic laws, with the goal of increasing foreign investment.

Economics Update

Find an update on China's special economic zones at **ClassZone.com**

FIGURE 18.7 ANNUAL ECONOMIC GROWTH RATE, CHINA AND SELECTED DEVELOPED NATIONS



Source: CIA World Factbook

APPLICATION Explaining an Economic Concept

C. What role do the SEZs play in China's transition to a market economy?

ECONOMICS SKILLBUILDER

For more on using a decision-making process, see the Skillbuilder Handbook, page R17.

Using a Decision-Making Process

Making decisions in complicated situations can be extremely difficult. Having a plan, or process, in place can be quite helpful.

TECHNIQUES USED IN MAKING DECISIONS Making decisions involves (1) gathering information to identify the situation in question, (2) identifying options, (3) predicting consequences, and (4) implementing a decision. The following passage describes the problem of flooding on China's Chang River. It illustrates the decision-making process.

Look for information that points to a situation that requires a decision. Figures on the deadly toll of flooding show that a decision on damming was needed.

Predict possible consequences. The positive and negative results of the dam are listed.

Controlling the Chang River

In the past 100 years, more than 1 million people have died as a result of flooding along China's Chang (Yangtze) River. After devastating floods in the 1950s, Chinese leader Mao Zedong ordered studies to see whether damming the river was feasible. Finally, in the 1990s, construction began on the Three Gorges Dam, which—when completed—will be the largest dam in the world. In addition to providing flood control, the dam will be a source of hydropower. Its turbines are expected to produce up to one-ninth of China's electricity. The dam's series of locks will allow ocean-going ships to sail 1,500 miles inland.

Nevertheless, the project has serious drawbacks. For one thing, it will require the resettlement of an estimated 1.2 million people. Environmentalists warn of water pollution, as well as the eradication of migratory fish and rare plants. The dam is scheduled for completion in 2009. In the meantime, the Chinese government has already begun to address the problem of pollution with the building of at least one comprehensive sewage treatment plant.

Look for any options that are offered. Here, only the option of damming the river is considered.

Decide what the result was. The dam is scheduled to be completed in 2009.

THINKING ECONOMICALLY Making Decisions

1. What choice did the government have regarding the flooding of the Chang River?
2. What economic incentives do you think may have added to the government's decision?
3. What consequences of the decision might be contrary to economic growth? Explain your answer.

SECTION 3 Assessment

Online Quiz
ClassZone.com

REVIEWING KEY CONCEPTS

1. 1. Explain the difference between these terms:
   a. *shock therapy* **b.** *perestroika*
2. What makes privatization a challenge in transitional economies?
3. What role does infrastructure play in transitional economies?
4. Why are special economic zones important to the growth of the Chinese economy?
5. In what way(s) is privatization an element of China's shift to a market economy?
6. **Using Your Notes** Write a summary of the challenges of economic transitions and explain how they have been addressed in the former Soviet bloc and in China. Refer to your completed cluster diagram.

   Use the Graphic Organizer at **Online Review @ ClassZone.com**

CRITICAL THINKING

7. **Comparing and Contrasting Economic Information** What are three key differences between the economic transitions of the former Soviet bloc and China?
8. **Making Inferences and Drawing Conclusions** While China has welcomed western economic principles, it has continued to come down hard on political freedoms. For example, Deng crushed protesters in Tiananmen Square in 1989. Why do you think capitalism can grow in China under a restrictive government when in the former Soviet bloc it went hand in hand with political freedom?
9. **Applying Economic Concepts** Explain how life in the former Soviet bloc changed for each of the following during a transition to a market economy.
   a. factory worker **b.** farmer **c.** consumer **d.** factory manager
10. **Challenge** Do businesses from foreign nations with strong anti-pollution laws have a responsibility to voluntarily limit pollution when located in a less developed country with less developed pollution laws? Give reasons for your answer.

ECONOMICS IN PRACTICE

Budapest, Hungary

Assessing Development

The chart below shows statistics from 2004 for Kyrgyzstan and Tajikistan, in Central Asia, and Hungary and Romania, in Eastern Europe.

	Kyrgyzstan	Tajikistan	Hungary	Romania
Gross national income ($ per capita)	268	154	4,913	1,729
Real GDP growth rate	6.0	10.5	3.9	8.1
Industrial production growth rate	6.0	8.2	9.6	4.0
Human development index (HDI)*	0.702	0.652	0.862	0.792

* Highest HDI is 1.0; lowest is 0.0.
Sources: CIA World Factbook; UNDP

Compare and Contrast Economic Information Write a paragraph comparing and contrasting the transition to a market economy in the selected Central Asian and Eastern European countries. Use the figures from the chart to explain the similarities and differences.

Challenge Why might the nation with the highest HDI, Hungary, also have the lowest real GDP growth?

Economics Update Find an update on this Case Study at **ClassZone.com**

China's Campaign for Economic Power

Background Since 1978, when China's former leader, Deng Xiaoping, made the decision to adopt free-market reforms, China's economy has been steadily gaining momentum. Deng's "four modernizations" (agriculture, industry, science and technology, and defense) have helped China become a player in the global economy in less than a generation.

Its success is based in part on its encouragement of foreign investment, the establishment of a number of special economic zones, and the opening of 14 coastal cities to foreign investment in 1984. Also, in 2001, China joined the World Trade Organization. Today, China's economic impact is too big to ignore.

What's the issue? What accounts for China's successful transition to a market economy? Study these sources to discover what fuels China's economic growth and how it affects the rest of the world.

A. Magazine Article

This article discusses some of the underlying reasons for China's growing impact on the global economy.

The Dragon Awakes

China is changing the dynamics of the global economy.

[China's] contribution to global GDP growth since 2000 has been almost twice as large as that of the next three biggest emerging economies, India, Brazil and Russia, combined. Moreover, there is [a] crucial reason why China's integration into the world economy is today having a bigger global impact than other emerging economies, or than Japan did during its period of rapid growth from the mid-1950s onwards. Uniquely, China combines a vast supply of cheap labor with an economy that is (for its size) unusually open to the rest of the world, in terms of trade and foreign direct investment. The sum of its total exports and imports of goods and services amounts to around 75% of China's GDP; in Japan, India and Brazil the figure is 25–30%. . . . As a result, the dragon's awakening is more traumatic for the rest of the world.

Source: ***The Economist*, July 28, 2005**

Thinking Economically Identify the aspect of China's economy that, according to the article, has had the most significant impact on the global economy, and explain why its impact has been so great.

B. Political Cartoon

The volume of China's exports has gotten a lot of attention in recent years.

Thinking Economically Why is it worth pointing out that China's exporting power seems to outstrip that of other nations?

C. Online News Story

China's economic growth frequently is referred to as an "economic miracle." The miracle, however, is not without problems.

China's Economic Miracle: the High Price of Progress

China's progress is uneven and sometimes problematic.

[China's] GDP is growing by 10 percent a year. Industrial production is galloping ahead at an annual rate of 17 percent. Its economy is now the second-biggest in the world, behind only the U.S., and there are predictions it will assume the top spot as early as 2020. . . .

China's explosive growth has come at a price. The economic gains have not been shared equally. Millions have become richer. But hundreds of millions have not. More than 60 percent of the population still toils in agriculture; the country's "economic miracle" has yet to make an appearance in much of the country. Corruption also remains well entrenched . . . [and] millions of workers have lost their jobs in the restructuring, prompting frequent protests. . . .

Source: **CBC News Online, April 20, 2005**

Thinking Economically Will China's economic growth alone increase the incomes of its poorest people? Why or why not?

THINKING ECONOMICALLY Synthesizing

1. All three documents point to China's success in international trade. What key element of financing development does document A cite as a component of China's success?
2. Documents A and B hint that the rest of the world is uneasy with China's economic growth, while document C discusses some of China's problems at home. Discuss these fears and problems in the context of what you've learned throughout Chapter 18.
3. Which factors do you think are most significant relative to China's economic growth? Explain why you think so. Use evidence from the documents in your answer.

Interactive Review

Review this chapter using interactive activities at **ClassZone.com**

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- Quizzes
- Vocabulary Flip Cards
- Graphic Organizers
- Review and Study Notes

Online Summary

Complete the following activity either on your own paper or online at **ClassZone.com**

Choose the key concept that best completes the sentence. Not all key concepts will be used.

debt restructuring
default
developed nations
infant mortality rate
International Monetary Fund (IMF)
less developed countries (LDC)
per capita GDP
"shock therapy"
stabilization program
privatization
World Bank

Nations with little industry and relatively low GDP are said to be __1__, while nations with a market economy and higher standard of living are known as __2__. Economists measure the level of a nation's development through such statistics as __3__, which allows for easy comparison with other countries because it shows the nation's output in relation to its population.

When nations set a course for development, they often seek loans from other nations. Some heavily indebted nations have gone into __4__ on their loans, being unable to pay them back. In those cases, nations can negotiate a __5__ plan to extend the payback and/or lower the payback rate.

Some economies are moving from central planning to an open market. These nations face a number of challenges. For example, there are questions about how to carry out __6__, the transfer of public property into individually owned property. There are also questions about the pace of change. __7__ involved suddenly removing governmental restrictions on the economy.

CHAPTER 18 Assessment

REVIEWING KEY CONCEPTS

Definitions of Development (pp. 544–551)

1. What are some features of a developed nation?
2. Name five measures economists use to gauge a nation's level of development.

A Framework for Economic Development Objectives (pp. 552–561)

3. Describe the internal and external goals a developing nation may set for itself.
4. In what ways can developing nations receive aid from other countries?

Transition to a Market Economy (pp. 562–571)

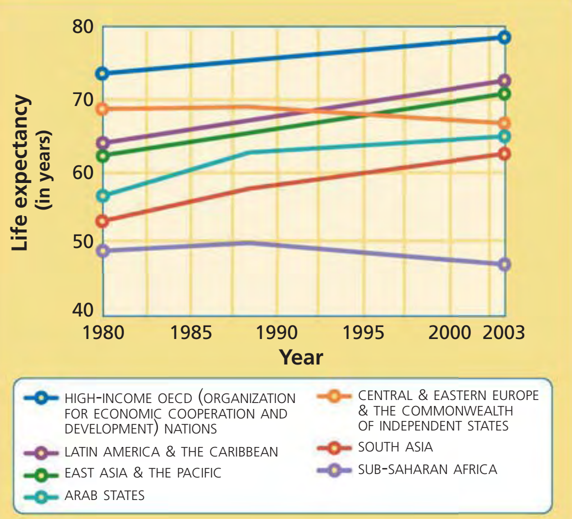
5. Name five challenges nations face when moving from a command economy to a market economy.
6. Briefly summarize the transition to a market economy in the former Soviet bloc and in China.

APPLYING ECONOMIC CONCEPTS

Look at the graph below showing life expectancy in various countries and regions from 1980 to 2003.

7. What explanation can you offer for the regions in which life expectancy declined?
8. In 2003, how much longer could someone living in a country that belongs to OECD expect to live than someone living in sub-Saharan Africa?

FIGURE 18.8 LIFE EXPECTANCY IN WORLD REGIONS



Source: U.N. Human Development Report, 2005

CRITICAL THINKING

9. Creating Graphs Create a graphic of your choice to show the figures below on the percentage of people living on $1 a day or less between 1981 and 2001.

Region	1981	1990	2001
East Asia & Pacific	56.7	29.5	14.3
Europe & Central Asia	0.8	0.5	3.5
Latin America & Caribbean	10.1	11.6	9.9
Middle East & North Africa	5.1	2.3	2.4
South Asia	51.5	41.3	31.9
Sub-Saharan Africa	41.6	44.5	46.4
World	40.4	26.3	20.7

Source: U.N. Human Development Report, 2005

Use **SMARTGrapher @ ClassZone.com** to complete this activity.

10. Analyzing and Interpreting Data Refer to the graph you created. In which region was the improvement in poverty most dramatic? In which regions did the situation worsen?

11. Analyzing Cause and Effect What might explain why this measure of poverty increased in Europe and Central Asia during this time period?

12. Making Inferences and Drawing Conclusions For each dollar spent on foreign aid by members of OECD, $10 is spent on the military. What can you conclude about the OECD member nations' concerns for the future?

13. Challenge A recent study found that an increase of ten mobile phones per 100 people raised GDP growth in a developing nation by ten percent. What might explain this? What does it suggest as a way to speed development?

SIMULATION

Work Toward Development Goals

In 2005, all the 191 members of the United Nations voted to adopt the Millennium Development Goals, with a target date of 2015 to have the goals realized.

Step 1 As a whole class, discuss the following eight goals that are part of this program:

1. Eradicate extreme poverty and hunger
2. Achieve universal primary education
3. Promote gender equality and empower women
4. Reduce child mortality
5. Improve maternal health
6. Combat HIV/AIDS, malaria, and other diseases
7. Ensure environmental sustainability
8. Develop a global partnership for development

Step 2 Break into eight small groups, one for each of the goals.

Step 3 Meet with your group and discuss concrete ways that the international community (either through such organizations as the IMF or World Bank or United Nations Development Program or through the efforts of individual nations or trading entities) can meet your goal and why it is important that it be met.

Step 4 Present your recommendations to the rest of the class.

Step 5 Follow up on the presentations with a discussion of how many different ways of approaching the problem surfaced and which seem most likely to lead to success.