Poverty, public finance, growth and development

Pearson Edexcel · International A-Level · Economics

Scope and prerequisites

This package now covers the full IA2 targets of specification sections 4.3.4–4.3.6 (32 objectives), grounded in specification pages 49–53 and WEC14 January 2025 and June 2025 papers and mark schemes. Read the native introduction first.

Key terms

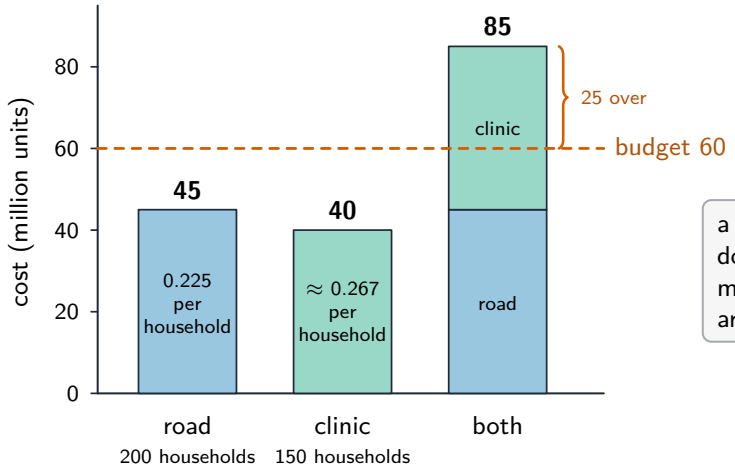
development ; **debt service** ; **absolute poverty** ; **relative poverty** ; **Lorenz curve** ; **Gini coefficient** ; **progressive tax** ; **regressive tax** ; **fiscal deficit** ; **national debt** ; **Human Development Index** ; **capital flight** .

Supported explanation

Growth describes an increase in real output; development also concerns health, education, capabilities and living conditions. Absolute poverty concerns meeting basic needs, while relative poverty compares resources with a society's usual standard. Inequality describes distribution. Average real income can rise while some people remain poor, so choose a measure suited to the claim.

Finance can enable investment but repayment, access, risk and currency terms matter. Aid can fund useful services or emergency relief; its effects depend on the recipient's needs, coordination, conditions and ability to maintain provision. Debt can finance future capacity, but servicing it uses resources and foreign-currency obligations can become harder after depreciation. Institutions affect dependable implementation, rights and accountability; a name or single index does not prove a project will work. Sustainable strategies compare present benefits with maintenance, distribution and environmental consequences. These are supported introductory mechanisms; complete development models, prescribed applications and detailed criteria remain in the held IA2 queue.

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a lower cost per household does not settle the choice: market access and health care are different benefits

Worked case

A fictional district has a 60-million-unit budget. A road costs 45 million and is expected to connect 200 households to markets. A clinic costs 40 million and is expected to reach 150 households. A report recommends the road because its cost per household is lower. Evaluate the decision.

Road cost per household = 45 million/200 = 0.225 million units/household. Clinic cost per household = 40 million/150 = approximately 0.267 million units/household. Both together cost 45 + 40 = 85 million, exceeding the budget by 25 million. The ratios measure different benefits, so they do not establish that the road is the better development choice. Check the main bottleneck, expected health and market effects, maintenance, access for disadvantaged households and environmental impacts. Compare feasible scaled options and financing terms; do not assume promised reach is actual reach.

Independent transfer

A foreign-currency loan can fund both projects, but a depreciation increases domestic debt-service cost. Propose a qualified decision and an evidence-based review.

Checked original model

Compare repayment and currency risk with credible project benefits and continuing service costs. Funding both now may displace later health, education or maintenance spending if debt service rises. Seek affordable terms or a feasible phased plan, examining distribution and environmental effects with affected people. Monitor actual access, health or market outcomes and repayment burden, not GDP or construction completion alone. A conditional choice explains the binding bottleneck and what evidence would change it. The detailed IA2 poverty, public-finance and development

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analysis is now taught in the sections below.

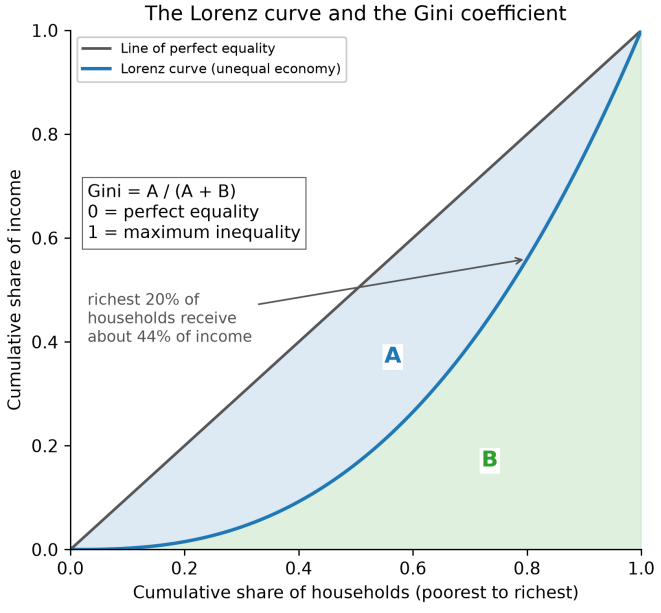
Poverty

Absolute poverty is inability to meet basic needs, measured against a stated minimum standard. In June 2025 the World Bank updated its international extreme-poverty line to 3.00 international dollars per person per day at 2021 purchasing-power parity. Comparisons must state the amount, PPP basis and reference date; this is not an ordinary exchange-rate conversion. Reference: World Bank poverty-line update. **Relative poverty** is poverty compared with the society around you – typically below a set share (often 60%) of median household income. Absolute poverty can fall while relative poverty rises, if growth lifts the poorest above the fixed line but the median rises faster.

Poverty changes with economic growth (lifts incomes, but distribution decides how much reaches the poor), education and training (raises earning power), welfare benefits, changes in the tax structure, structural change (declining industries strand workers), aid, and civil wars and conflict, which destroy assets and displace people.

Inequality

Income inequality concerns flows (wages, profits, benefits); wealth inequality concerns stocks (property, savings, shares). Wealth is usually far more unequally held than income because assets compound across generations.



The **Lorenz curve** plots the cumulative share of income received by the cumulative share of households, poorest first. The **Gini coefficient** is A/(A+B): 0 is perfect equality and 1 is maximum inequality (as a percentage, multiply by 100 – Uruguay's

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rise from 39.4 to 41.0 between 2017 and 2021, tested in June 2025, means inequality increased and the Lorenz curve moved away from the line of equality). Causes within countries include skill-biased technical change, asset ownership, tax/benefit design and labour-market power; between countries, different resource endowments, institutions and development levels.

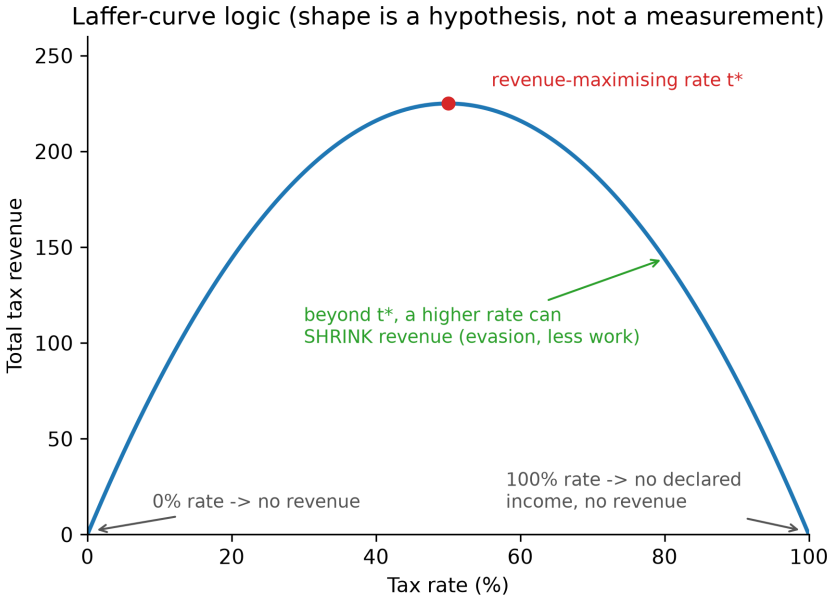
Impacts to evaluate: inequality can sharpen incentives and enterprise and raise saving among the rich, but extreme gaps cut the poor's access to education and health (lowering life expectancy), fuel emigration, and can weaken social trust and demand. Development often widens inequality first as a modern sector grows, then narrows it – an empirical question, not a law. Capitalism rewards asset ownership and risk-taking, so free markets tend to generate inequality; the evaluation is whether the resulting incentives and growth fund redistribution, or whether market power and inherited wealth entrench it.

Public expenditure and taxation

Public spending splits into capital expenditure (infrastructure that lasts), current expenditure (salaries, supplies) and **transfer payments** (benefits and pensions – no output in return). Its size and pattern shift internationally with incomes (richer states spend more), age distributions (ageing raises pension and health costs) and expectations of what the state should do. A high spending-to-GDP ratio can raise productivity and growth (better infrastructure, education) but risks **crowding out** (state borrowing raises interest rates or absorbs funds private firms could use) and needs higher taxation.

Direct taxes fall on income and wealth (income tax, corporation tax); **indirect taxes** fall on spending (sales taxes, excise duties). A progressive tax takes a rising share as income rises, a **proportional tax** a constant share, a regressive tax a falling share (indirect taxes are usually regressive because the poor spend a larger share of income).

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Effects of tax-rate changes to evaluate: work incentives (higher marginal rates may discourage extra work); the **Laffer curve** hypothesis – revenue is zero at 0% and at 100%, so beyond some rate a further rise shrinks revenue through evasion and reduced effort (a hypothesis about shape, not a measured fact); income distribution; real output and employment; the price level (indirect-tax rises feed inflation); the trade balance (demand compression cuts imports); and FDI flows (investors compare after-tax returns).

Deficits, debt and macroeconomic policy

Distinguish carefully: a **fiscal deficit** is a year's shortfall (spending above revenue); the **national debt** is the accumulated stock of past borrowing; a surplus is the reverse flow. **Automatic stabilisers** (benefit spending rises and tax revenue falls in a downturn) work without new decisions; discretionary policy is a deliberate change. A **structural deficit** persists at full employment; a cyclical deficit comes from the downturn itself. Deficit size and debt size depend on growth, interest rates, demography, wars and crises.

Significance: larger borrowing can push interest rates up; debt service (interest and scheduled principal repayments) crowds out other spending – Italy's public expenditure rising from 47.1% to 56.7% of GDP between 2002 and 2022 (examined in June 2025) illustrates the debate; and high debt shifts costs to future taxpayers, an intergenerational-equity question.

Governments combine fiscal, monetary, exchange-rate and supply-side policies and direct controls to cut deficits and debt, control inflation, respond to external shocks and reduce poverty. In the 2008 global financial crisis, demand-side policy dominated: interest rates cut near zero, quantitative easing, and large fiscal stimulus and bank res-

cues – followed by arguments over austerity. Controlling TNC tax avoidance means regulating transfer pricing and coordinating across borders; limits are real: capital is mobile, information is asymmetric, and national law stops at the border. Policy changes act at local, national and global levels at once. And policymakers work with inaccurate data, risk and uncertainty, and external shocks they cannot control – reasons to build in review rather than claim certainty.

Growth and development

The **Human Development Index** combines three components: health (life expectancy at birth), education (mean and expected years of schooling) and income (GNI per capita, log-scaled). It beats GDP alone because development is broader than output; its limits are that it says nothing about inequality, sustainability or political freedom, and data quality varies. Other indicators: the share of adult male labour in agriculture (falls as economies develop), access to clean water, energy use per head, and internet, mobile-phone and doctor access per thousand people.

Constraints on growth and development – economic: commodity-price volatility and primary-product dependency (the Prebisch-Singer hypothesis: primary exporters' terms of trade worsen over time because demand for raw materials grows slowly with income); the savings gap (the Harrod-Domar logic: low income → low saving → low investment → low growth); the foreign-currency gap (export earnings too small to pay for needed capital imports); **capital flight**; demography (youth bulges, ageing, migration); household and overseas debt; weak credit and banking access; poor infrastructure; low education and skills. Non-economic: corruption, poor governance, civil wars, migration of skilled workers, terrorism.

Strategies to promote growth and development divide into market-oriented (trade liberalisation, FDI promotion, subsidy removal, privatisation, floating exchange rates, **microfinance**), interventionist (human-capital development, protectionism, managed exchange rates, infrastructure, joint ventures with TNCs, **buffer stocks** to stabilise commodity prices) and others: industrialisation through the Lewis dual-sector model (labour moves from low-productivity traditional agriculture to a higher-productivity modern sector, funding investment from the surplus), tourism, developing primary industries, debt relief and aid. International institutions: the **World Bank** funds long-run development projects; the **IMF** supports balance-of-payments stability with conditions; NGOs deliver targeted local programmes. Every strategy needs evaluation in context – property rights, governance and the binding constraint differ by country.

WEC14 assessment demand for this topic

Section A has tested HDI-based development strategies (January 2025 Q1), index-number calculation (Q4) and reading a Gini-coefficient chart (June 2025 Q6). Section C essays include reducing income inequality in a developed country (January 2025

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Q8), development constraints in a named developing country (June 2025 Q9) and the effects of a rising public-expenditure share (June 2025 Q10). The 12 + 8 rubric and the named-country requirement apply exactly as certified for topics 5 and 7.

Source boundary

XEC11/YEC11, 2018 specification, Issue 2. Evidence: specification pages 49–53 (sections 4.3.4–4.3.6), WEC14 January 2025 QP/MS (Section A Q1, Q4; Section C Q8) and June 2025 QP/MS (Section A Q6; Section C Q9, Q10). Local authored marking guidance is not an official qualification scheme.

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