

3.2: Classifying World Economies

Learning Objectives

1. Understand how economies are classified.
2. Evaluate the statistics used in classifications: GNP, GDP, PPP as well as HDI, HPI, GDI, and GEM.

Classification of Economies

Experts debate exactly how to define the level of economic development of a country—which criteria to use and, therefore, which countries are truly developed. This debate crosses political, economic, and social arguments.

When evaluating a country, a manager is assessing the country's income and the purchasing power of its people; the legal, regulatory, and commercial infrastructure, including communication, transportation, and energy; and the overall sophistication of the business environment.

Why does a country's stage of development matter? Well, if you're selling high-end luxury items, for example, you'll want to focus on the per capita income of the local citizens. Can they afford a \$1,000 designer handbag, a luxury car, or cutting-edge, high-tech gadgets? If so, how *many* people can afford these expensive items (i.e., how large is the domestic market)? For example, in January 2011, the *Financial Times* quotes Jim O'Neill, a leading business economist, who states, "South Africa currently accounts for 0.6 percent of world GDP. South Africa can be successful, but it won't be big." Jennifer Hughes, "'Bric' Creator Adds Newcomers to List," *Financial Times*, January 16, 2010, accessed January 7, 2011, <http://www.ft.com/cms/s/0/f717c8e8-21be-11e0-9e3b-00144feab49a.html#ixzz1MKbbO8ET>. Section 4.4 discusses the debate around the term *emerging markets* and which countries should be labeled as such. But clearly the size of the local market is an important key factor for businesspeople.

Even in developing countries, there are always wealthy people who want and can afford luxury items. But these consumers are just as likely to head to the developed world to make their purchase and have little concern about any duties or taxes they may have to pay when bringing the items back into their home country. This is one reason why companies pay special attention to understanding their global consumers as well as where and how these consumers purchase goods. Global managers also focus on understanding if a country's target market is growing and by what rate. Countries like China and India caught the attention of global companies, because they had large populations that were eager for foreign goods and services but couldn't afford them. As more people in each country acquired wealth, their buying appetites increased. The challenge is how to identify which consumers in which countries are likely to become new customers. Managers focus on globally standard statistics as one set of criteria to understand the stage of development of any country that they're exploring for business. "Global Economies," *CultureQuest Global Business Multimedia Series* (New York: Atma Global, 2010).

Let's look more closely at some of these globally standard statistics and classifications that are commonly used to define the stage of a country's development.

Statistics Used in Classifications

Gross Domestic Product

Gross domestic product (GDP) is the value of all the goods and services produced by a country in a single year. Usually quoted in US dollars, the number is an official accounting of the country's output of goods and services. For example, if a country has a large black, or underground, market for transactions, it will not be included in the official GDP. Emerging-market countries, such as India and Russia, historically have had large black-market transactions for varying reasons, which often meant their GDP was underestimated.

Figure 4.1

Rank	Country	GDP (purchasing power parity)
1	European Union	\$14,430,000,000,000
2	United States	\$14,140,000,000,000
3	China	\$8,748,000,000,000
4	Japan	\$4,150,000,000,000
5	India	\$3,570,000,000,000
6	Germany	\$2,810,000,000,000
7	United Kingdom	\$2,128,000,000,000
8	Russia	\$2,110,000,000,000
9	France	\$2,097,000,000,000
10	Brazil	\$2,013,000,000,000
11	Italy	\$1,739,000,000,000
12	Mexico	\$1,465,000,000,000
13	South Korea	\$1,364,000,000,000
14	Spain	\$1,362,000,000,000
15	Canada	\$1,269,000,000,000
16	Indonesia	\$962,500,000,000
17	Turkey	\$874,500,000,000
18	Australia	\$851,100,000,000
19	Iran	\$827,100,000,000
20	Taiwan	\$735,400,000,000

Source: US Central Intelligence Agency, “Country Comparison: GDP (PPP),” *World Factbook*, accessed June 3, 2011, www.cia.gov/library/publications/the-world-factbook/rankorder/2001rank.html.

Figure 4.1 shows the total size of the economy, but a company will want to know the income per person, which may be a better indicator of the strength of the local economy and the market opportunity for a new consumer product. GDP is often quoted on a per person basis. **Per capita GDP** is simply the GDP divided by the population of the country.

The per capita GDP can be misleading because actual costs in each country differ. As a result, more managers rely on the **GDP per person** adjusted for purchasing power to understand how much income local residents have. This number helps professionals evaluate what consumers in the local market can afford.

Companies selling expensive goods and services may be less interested in economies with low per capita GDP. Figure 4.2 shows the income (GDP) on a per person basis. For space, the chart has been condensed by removing lower profile countries, but the ranks are valid. Surprisingly, some of the hottest emerging-market countries—China, India, Turkey, Brazil, South Africa, and Mexico—rank very low on the income per person charts. So, why are these markets so exciting? One reason might be that companies selling cheaper, daily-use items, such as soap, shampoos, and low-end cosmetics, have found success entering developing, but promising, markets.

Figure 4.2 Per Capita GDP on a Purchasing Power Parity Basis

Rank	Country	GDP Per Capita (PPP) 2007 Estimates
1	Liechtenstein	\$122,100
2	Qatar	\$119,500
3	Luxembourg	\$79,600
4	Bermuda	\$69,900
5	Norway	\$57,400
6	Jersey	\$57,000
7	Kuwait	\$52,800
8	Singapore	\$52,200
9	Brunei	\$51,200
10	Faroe Islands	\$48,200
11	United States	\$46,000
15	Hong Kong	\$42,800
17	Switzerland	\$41,400
18	Ireland	\$41,000
19	Australia	\$40,000
20	Iceland	\$39,600
21	Netherlands	\$39,500
22	Austria	\$39,200
23	United Arab Emirates	\$38,900
24	Bahrain	\$38,800
27	Canada	\$38,200
29	Belgium	\$36,800
30	Sweden	\$36,600
31	Denmark	\$36,000
32	Greenland	\$35,900
35	United Kingdom	\$34,800
36	Finland	\$34,100
37	Germany	\$34,100
38	Spain	\$33,600
40	Japan	\$32,700
41	France	\$32,600
42	European Union	\$32,500

Rank	Country	GDP Per Capita (PPP) 2007 Estimates
43	Taiwan	\$32,000
44	Greece	\$31,000
46	Italy	\$29,900
48	Israel	\$28,400
49	South Korea	\$28,100
50	Slovenia	\$27,700
51	New Zealand	\$27,400
53	Czech Republic	\$24,900
56	Portugal	\$21,700
58	Slovakia	\$21,100
59	Cyprus	\$21,000
61	Saudi Arabia	\$20,600
62	Hungary	\$18,800
63	Estonia	\$18,500
65	Poland	\$17,900
68	Croatia	\$17,500
69	Puerto Rico	\$17,100
72	Russia	\$15,100
74	Malaysia	\$14,900
76	Chile	\$14,600
80	Argentina	\$13,400
83	Mexico	\$13,200
85	Venezuela	\$13,000
97	Turkey	\$11,400
101	World Average	\$10,400
104	South Africa	\$10,300
107	Brazil	\$10,100
119	Thailand	\$8,200
128	China	\$6,600
136	Egypt	\$6,000
163	India	\$3,100

Source: US Central Intelligence Agency, “Country Comparison: GDP—Per Capita (PPP),” *World Factbook*, accessed June 3, 2011, www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html.

Purchasing Power Parity

To compare production and income across countries, we need to look at more than just GDP. Economists seek to adjust this number to reflect the different costs of living in specific countries. **Purchasing power parity (PPP)** is, in essence, an economic theory that adjusts the exchange rate between countries to ensure that a good is purchased for the same price in the same currency. For example, a basic cup of coffee should cost the same in London as in New York.

A nation’s GDP at purchasing power parity (PPP) exchange rates is the sum value of all goods and services produced in the country valued at prices prevailing in the United States. This is the measure most economists prefer when looking at per-capita welfare and when comparing living conditions or use of resources across countries. The measure is difficult to compute, as a US dollar value has to be assigned to all goods and services in the country regardless of whether these goods and services have a direct equivalent

in the United States (for example, the value of an ox-cart or non-US military equipment); as a result, PPP estimates for some countries are based on a small and sometimes different set of goods and services. In addition, many countries do not formally participate in the World Bank's PPP project to calculate these measures, so the resulting GDP estimates for these countries may lack precision. For many developing countries, PPP-based GDP measures are multiples of the official exchange rate (OER) measure. The differences between the OER- and PPP-denominated GDP values for most of the wealthy industrialized countries are generally much smaller. US Central Intelligence Agency, "Country Comparison: GDP (PPP)," *World Factbook*, accessed January 3, 2011, www.cia.gov/library/publications/the-world-factbook/rankorder/2001rank.html.

In some countries, like Germany, the United Kingdom, or Japan, the cost of living is quite high and the per capita GDP (nominal) is higher than the GDP adjusted for purchasing power. Conversely, in countries like Mexico, Brazil, China, and India, the per capita GDP adjusted for purchasing power is higher than the nominal per capita GDP, implying that local consumers in each country can afford more with their incomes.

Figure 4.3 Per Capita GDP (Nominal) versus Per Capita GDP (PPP) of Select Countries (2010)

Country	Per Capita GDP (Nominal)	Per Capita GDP (PPP)
United States	47,100	47,400
Germany	40,500	35,900
United Kingdom	36,200	35,100
Japan	42,500	34,200
Mexico	8,900	13,800
Brazil	10,100	10,900
China	4,300	7,400
India	1,200	3,400

Sources: "List of Countries by GDP (Nominal) Per Capita," Wikipedia, [http://en.Wikipedia.org/wiki/List_of_countries_by_GDP_\(nominal\)_per_capita](http://en.Wikipedia.org/wiki/List_of_countries_by_GDP_(nominal)_per_capita). "Country Comparison: GDP—Per Capita (PPP)," US Central Intelligence Agency, www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html.

Human Development Index (HDI)

GDP and purchasing power provide indications of a country's level of economic development by using an income-focused statistic. However, in recent years, economists and business analysts have focused on indicators that measure whether people's needs are satisfied and whether the needs are equally met across the local population. One such indication is the **human development index (HDI)**, which measures people's satisfaction in three key areas—long and healthy life in terms of life expectancy; access to quality education equally; and a decent, livable standard of living in the form of income.

Since 1990, the United Nations Development Program (UNDP) has produced an annual report listing the HDI for countries. The HDI is a summary composite index that measures a country's average achievements in three basic aspects of human development: health, knowledge, and a decent standard of living. Health is measured by *life expectancy* at birth; knowledge is measured by a combination of the adult *literacy* rate and the combined primary, secondary, and tertiary gross enrollment ratio; and standard of living by (*income as measured by*) GDP per capita (PPP US\$). UNDP, "Frequently Asked Questions (FAQs) about the Human Development Index (HDI): What Is the HDI?," *Human Development Reports*, accessed May 15, 2011, <http://hdr.undp.org/en/statistics/hdi>.

While the HDI is not a complete indicator of a country's level of development, it does help provide a more comprehensive picture than just looking at the GDP. The HDI, for example, does not reflect political participation or gender inequalities. The HDI and the other composite indices can only offer a broad proxy on some of the key the issues of human development, gender disparity, and human poverty. UNDP, "Is the HDI Enough to Measure a Country's Level of Development?," *Human Development Reports*, accessed May 15, 2011, <http://hdr.undp.org/en/statistics/hdi>. Table 4.1 shows the rankings of the world's countries for the HDI for 2010 rankings. Measures such as the HDI and its components allow global managers to more accurately gauge the local market.

Table 4.1 Human Development Index (HDI)—2010 Rankings

Very High Human Development	High Human Development	Medium Human Development	Low Human Development
1. Norway	43. Bahamas	86. Fiji	128. Kenya
2. Australia	44. Lithuania	87. Turkmenistan	129. Bangladesh
3. New Zealand	45. Chile	88. Dominican Republic	130. Ghana
4. United States	46. Argentina	89. China	131. Cameroon
5. Ireland	47. Kuwait	90. El Salvador	132. Myanmar
6. Liechtenstein	48. Latvia	91. Sri Lanka	133. Yemen
7. Netherlands	49. Montenegro	92. Thailand	134. Benin
8. Canada	50. Romania	93. Gabon	135. Madagascar
9. Sweden	51. Croatia	94. Suriname	136. Mauritania
10. Germany	52. Uruguay	95. Bolivia (Plurinational State of)	137. Papua New Guinea
11. Japan	53. Libyan Arab Jamahiriya	96. Paraguay	138. Nepal
12. Korea (Republic of)	54. Panama	97. The Philippines	139. Togo
13. Switzerland	55. Saudi Arabia	98. Botswana	140. Comoros
14. France	56. Mexico	99. Moldova (Republic of)	141. Lesotho
15. Israel	57. Malaysia	100. Mongolia	142. Nigeria
16. Finland	58. Bulgaria	101. Egypt	143. Uganda
17. Iceland	59. Trinidad and Tobago	102. Uzbekistan	144. Senegal
18. Belgium	60. Serbia	103. Micronesia (Federated States of)	145. Haiti
19. Denmark	61. Belarus	104. Guyana	146. Angola
20. Spain	62. Costa Rica	105. Namibia	147. Djibouti
21. Hong Kong, China (SAR)	63. Peru	106. Honduras	148. Tanzania (United Republic of)
22. Greece	64. Albania	107. Maldives	149. Côte d'Ivoire

Very High Human Development	High Human Development	Medium Human Development	Low Human Development
23. Italy	65. Russian Federation	108. Indonesia	150. Zambia
24. Luxembourg	66. Kazakhstan	109. Kyrgyzstan	151. Gambia
25. Austria	67. Azerbaijan	110. South Africa	152. Rwanda
26. United Kingdom	68. Bosnia and Herzegovina	111. Syrian Arab Republic	153. Malawi
27. Singapore	69. Ukraine	112. Tajikistan	154. Sudan
28. Czech Republic	70. Iran (Islamic Republic of)	113. Vietnam	155. Afghanistan
29. Slovenia	71. The former Yugoslav Republic of Macedonia	114. Morocco	156. Guinea
30. Andorra	72. Mauritius	115. Nicaragua	157. Ethiopia
31. Slovakia	73. Brazil	116. Guatemala	158. Sierra Leone
32. United Arab Emirates	74. Georgia	117. Equatorial Guinea	159. Central African Republic
33. Malta	75. Venezuela (Bolivarian Republic of)	118. Cape Verde	160. Mali
34. Estonia	76. Armenia	119. India	161. Burkina Faso
35. Cyprus	77. Ecuador	120. Timor-Leste	162. Liberia
36. Hungary	78. Belize	121. Swaziland	163. Chad
37. Brunei Darussalam	79. Colombia	122. Lao People's Democratic Republic	164. Guinea-Bissau
38. Qatar	80. Jamaica	123. Solomon Islands	165. Mozambique
39. Bahrain	81. Tunisia	124. Cambodia	166. Burundi
40. Portugal	82. Jordan	125. Pakistan	167. Niger
41. Poland	83. Turkey	126. Congo	168. Congo (Democratic Republic of the)
42. Barbados	84. Algeria 85. Tonga	127. São Tomé and Príncipe	169. Zimbabwe

Source: UNDP, “Human Development Index (HDI)—2010 Rankings,” *Human Development Reports*, accessed January 6, 2011, <http://hdr.undp.org/en/statistics>.

In 1995, the UNDP introduced two new measures of human development that highlight the status of women in each society.

The first, *gender-related development index (GDI)*, measures achievement in the same basic capabilities as the HDI does, but takes note of inequality in achievement between women and men. The methodology used imposes a penalty for inequality, such that the GDI falls when the achievement levels of both women and men in a country go down or when the disparity between their achievements increases. The greater the gender disparity in basic capabilities, the lower a country’s GDI compared with its HDI. The GDI is simply the HDI discounted, or adjusted downwards, for gender inequality.

The second measure, *gender empowerment measure (GEM)*, is a measure of agency. It evaluates progress in advancing women’s standing in political and economic forums. It examines the extent to which women and men are able to actively participate in economic and political life and take part in decision making. While the GDI focuses on expansion of capabilities, the GEM is concerned with the use of those capabilities to take advantage of the opportunities of life. UNDP, “Measuring Inequality: Gender-related Development Index (GDI) and Gender Empowerment Measure (GEM),” *Human Development Reports*, accessed January 3, 2011, hdr.undp.org/en/statistics/indices/gdi_gem.

In 1997, UNDP added a further measure—the **human poverty index (HPI)**.

If human development is about enlarging choices, poverty means that opportunities and choices most basic to human development are denied. Thus a person is not free to lead a long, healthy, and creative life and is denied access to a decent standard of living, freedom, dignity, self-respect and the respect of others. From a human development perspective, poverty means more than the lack of what is necessary for material well-being.

For policy-makers, the poverty of choices and opportunities is often more relevant than the poverty of income. The poverty of choices focuses on the causes of poverty and leads directly to strategies of empowerment and other actions to enhance opportunities for everyone. Recognizing the poverty of choices and opportunities implies that poverty must be addressed in all its dimensions, not income alone. UNDP, “The Human Poverty Index (HPI),” *Human Development Reports*, accessed January 3, 2011, hdr.undp.org/en/statistics/indices/hpi.

Rather than measure poverty by income, the HPI is a composite index that uses indicators of the most basic dimensions of deprivation: a short life (longevity), a lack of basic education (knowledge), and a lack of access to public and private resources (decent standard of living). There are two different HPIs—one for developing countries (HPI-1) and another for a group of select high-income OECD (Organization for Economic and Development) countries (HPI-2), which better reflects the socioeconomic differences between the two groups. HPI-2 also includes a fourth indicator that measures social exclusion as represented by the rate of long-term unemployment. UNDP, “The Human Poverty Index (HPI),” *Human Development Reports*, accessed January 3, 2011, hdr.undp.org/en/statistics/indices/hpi.

Why Does All This Matter to Global Business?

So, the richest countries—like Liechtenstein, Qatar, and Luxembourg—may *not* always have big local markets or, in contrast, the poorest countries may *have* the largest local market as determined by the size of the local population. Savvy business managers need to compare and contrast a number of different classifications, statistics, and indicators before they can interpret the strength, depth, and extent of a local market opportunity for their particular industry and company.

The goal of this chapter is to review a sampling of countries in the developed, developing, and emerging markets to understand how economists and businesspeople perceive market opportunities. Of course, one chapter can’t do justice to all of these markets, but through select examples, you’ll see how countries have evolved in the post–World War II global economic, political, and social environments. Remember that the goal of any successful businessperson is to monitor the changing markets and spot opportunities and trends ahead of his or her peers.

Advice to Students

The major classifications used by analysts are evolving. The primary criteria for determining the stage of development may change within a decade as demonstrated with the addition of the gender and poverty indices. In addition, with every global crisis or event, there’s a tendency to add more acronyms and statistics into the mix. Savvy global managers have to sort through these to determine what’s relevant to their industry and their business objectives in one or more countries. For example, in the fall of 2010, after two years of global financial crisis, global investors started using a new acronym to describe the changing economic fortunes among countries: HIICs, or heavily indebted industrialized countries. These countries include the United States, the United Kingdom, and Japan. “‘Developed markets are basically behaving like emerging markets,’ says HSBC’s Richard Yetsenga. ‘And emerging markets are quickly becoming more developed.’” Kelly Evans, “‘HIIC’ Nations Are Acting Like Backwaters,” *Wall Street Journal*, October 1, 2010, accessed January 3, 2011, <http://online.wsj.com/article/SB10001424052748704789404575524402059410506.html>. Investors are pulling money from the developed countries and into the BRIC countries (i.e., Brazil, Russia, India, and China), which are “‘where the population growth is, where the raw materials are, and where the economic growth is,’ says Michael Penn, global equity strategist at Bank of America Merrill Lynch.” Kelly Evans, “‘HIIC’ Nations Are Acting Like Backwaters,” *Wall Street Journal*, October 1, 2010, accessed January 3, 2011, <http://online.wsj.com/article/SB10001424052748704789404575524402059410506.html>. *The key here is to understand that classifications—just like countries and international business—are constantly evolving.*

Rather than being overwhelmed by the evolving data, it’s critical to understand *why* the changes are occurring, *what* attitudes and perceptions are shifting, and *if* they are supported by real, verifiable data. In the above example of HIICs, investors from the major economies are likely motivated by quick gains on stock prices and the prevailing perception that emerging markets offer companies the best growth prospects. But as a businessperson, the timeline for your company would be in years, not months; so it’s important

to evaluate information based on your company's goals rather than relying on the media, investment markets, or other singularly focused industry professionals.

To truly monitor the global business arena and select prospective countries, you need to follow the news, trends, and available information for a period of time. Over time, savvy global managers develop a geographic, industrial, or product expertise—or some combination. Those who become experts on a specific country spend a great deal of time in the country, sometimes learn the language, and almost always develop an understanding of the country's political, economic, and social history as well as its culture and evolution. They gain a deeper knowledge of more than just the country's current business environment. In the business world, these folks are affectionately called “old hands”—as in he is an “old China hand” or an “old Indonesia hand.” This is a reflection of how seasoned or experienced a person is with a country.

KEY TAKEAWAYS

- There are some classifications that are commonly used to define a stage of a country's development. The GDP is the value of all the goods and services produced by a country in a single year. The income per person, a better indicator of the strength of the local economy and the market opportunity for a new consumer product, is the nominal per capita GDP—the GDP divided by the population of the country. Finally, to compare production and income across countries, economists adjust this number to reflect the different costs of living in specific countries. PPP adjusts the exchange rate between countries to ensure that a good is purchased for the same price in the same currency.
- The HDI measures people's satisfaction in three key areas: (1) long and healthy life in terms of life expectancy; (2) access to quality education equally; and (3) a decent standard of living in the form of income. Health is measured by *life expectancy* at birth; knowledge is measured by a combination of the adult *literacy* rate and the combined primary, secondary, and tertiary gross enrollment ratio; and standard of living by (*income as measured by*) per capita GDP.
- Standards are constantly evolving to meet changing global scenarios; for instance, in 1997, the UNDP added the HPI to factor in the denial of basic opportunities and choices to those who live in poverty. It's critical to understand *why* the changes are occurring, *what* attitudes and perceptions are shifting, and *if* they are supported by real, verifiable data.

EXERCISES

(AACSB: Reflective Thinking, Analytical Skills)

1. Describe the main criteria used to classify economies.
2. Select two countries on Figure 4.1 identifying GDP per person and research the local economy. Are your findings consistent with what you would expect based on the country rankings? What is the human development ranking for each country? In your opinion, are these rankings consistent with the GDP rankings?

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