UNIT ONE

INTRODUCTION TO DEVELOPMENT ECONOMICS

Development economics is a vast subject, covering a whole range of issues, including some quintessential problems of underdevelopment. This branch of economics is a distinct yet very important extension of both traditional economics and political economy. While presumably concerned with efficient allocation of resources and the steady growth of aggregate output over time, development economics is assumed to focus on the economic, social and institutional mechanisms needed to cause rapid changes in levels of living for masses in developing countries.

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Lesson 1: Introduction to Development Economics

Objectives:

After studying this lesson, you will be able to:

- Familiarise development economics and its schools of thoughts.
- Be acquainted with the meaning of development.
- Analyse the agenda for the New Development Economics.

Introduction

The emergence of development economics as a separate branch is new; but the study of development is as old as the economics itself. The development economics, if one formulates the part of economics that tries to analyse the growth of the economy as a whole, may be traced back to 1776, when Adam Smith published *The Wealth of Nations.* The eighteenth century also provides us treatises dwelling on constraints imposed on growth by agricultural surplus, foreign exchange and savings. The classicists also discourse on quantity theory of money, inflation, continual unemployment, entrepreneurship as a separate factor of production, the incidence of tax credit, etc. The first half of nineteenth century produces landmark works on law of diminishing returns, the law of comparative cost, population theory, and theory of land tenure. After that the interests in development theory almost die out until 1950s.

The 1950's witnessed a theoretical explosion in the pretext of limited usefulness of orthodox economics. Putting standard neo-classical economics almost on the defensive terrain, a number of approaches emerged which may be somewhat classified loosely as neo-classical, Marxists and structuralist-institutionalist. Of course, each contains widely diverse strands of methodology and analytical assumptions. There are indeed differences within the club – between neo-classicals in the Walras-Debreu tradition and those of information-theoretic school.

Different Perspectives

A lively debate continues about which theory is appropriate to explain facts and address the issues of development. The mainstream theories or neo-classical school that emphasises free markets and laissez faire and opposes the government intervention has reasserted its dominance over the structuralist or development economics school, yet other heterodox theories broaden and extend the scope of the development discipline.

The disagreements originate about the assumption of theory and rejection of the implications of the policies. The first part relates to an aspect of positive economics, a scientific question that can be resolved through data while second is an aspect of normative economics pertaining to outcomes – a difference in tastes or values that cannot be resolved by argument.

The neo-classical school holds that prices crucially influence economic behaviour, subject to famous qualifier "other things being equal" which include such variables as income, tastes, habits and the given information. In comparison to price, the structuralists, by contrast, tend to stress on these variables. The difference can be appreciated by an example: Does the demand for umbrella depend more on price or on rainy days? If one thinks in favour of former, neo-classical analysis is appropriate, while structuralist economics is more appropriate if s/he thinks in favour of the latter.

Neoclassicals assume agents are fairly responsive (indicated by elastic slope of the demand curve) in comparison to changes other variables (shift of the demnd curve). Arguing that structural constraints are far more relevant to developing countries, the structuralists assert that simply letting prices adjust will do nothing to relax these constraints.

The neo-classicals concede that free market policy becomes inappropriate in circumstances of market failure (e.g. market failures occur in case of monopolies or such external factors), resulting in non-attainment of the promised efficiency due to absence of a free market equilibrium. Cambridge (UK) Professor Joan Robinson in her book *Aspects of Development and Underdevelopment* (1979) argued that such conditions are widespread in developing world where markets are underdeveloped too. But the neo-classical make a strong rejoinder; UCLA Professor Deepak Lal attacks the claim that underdeveloped countries suffer from unique kind of market failures in The *Poverty of Development Economics* (1983), saying this is an empirical rather than a theoretical question. Another rationalisation for a separate development economics is that profound structural change cause long lags in adjustment.

Theories inspired by Marxism reject the neo-classical orthodoxy for a different set of reasons. Rejecting the neo-classical faith in mutual gains, such theories give prominence to the power relationships amongst economic groups, stressing that one party's gain is another (weaker) party's loss. Dependency theory is related school that was prompted by the Latin American disappointment with the benefits of trade promised by neo-classical theory.

Neo-classical thinking has been further criticised for its underlying assumptions that stress methodological individualism, based on Western norms that glorify the role of the autonomous and idiosyncratic decision-maker. The view is that social aggregates are supposed to be nothing but sum of these individuals interacting each other through an impersonal market. Interpersonal interactions in traditional societies are, however, usually not based on such individualistic principles.

In the face of all these challenges, there has been a resurgence of neo-classical ideas with the support of international financial institutions such as, World Bank. The reappraisal in the pas twenty years was aided in no small measures by visible example of various success stories that relied on free market policies (e.g. Taiwan and Hong Kong). Other successful countries, such as South Korea, pursued much more interventionist policies. This stood in sharp contrast to either neo-classical or structuralist school.

A.O. Hirschman (1981) pointed out that normative, rather than analytical differences might animate the development debate.

- Many analysts may reject neo-classical economics because they perceive this framework places paramount emphasis on efficiency, as opposed to such goals as equity.
- Another distinct goal is national sovereignty. But free trade along neo-classical lines is seen to inevitably reduce the scope for national autonomy.
- Those favouring nationalistic values also tend to approve of centralised control; thus they distrust private enterprise and the consumer sovereignty that flourish with in decentralised free markets. (One historical example in the Peronist regime in Argentina during the 1950s and 1960s; another familiar example in the dominant ideology of Mexico until 1980s) The desire for national autonomy remains particularly strong in nations that were long under the colonial yoke. Yet, all the countries in the world are now obliged to admit limits on the ideal of sovereignty.
- A free trade strategy is also deplored because of its perceived stress on exports of low-tech primary goods. Instead, many LDCs want their development to be based on advanced manufacturing capabilities.

Possibly the most important normative objection to neo-classical economics arises from fears of adverse distribution consequence that may flow from it. Proponents counter that neo-classical policies do not inevitably lead to greater inequality, pointing to the empirical example of improved equity in newly industrialised countries. Neo-classical theory makes a sharp separation of production from distribution: organise production along efficient neo-classical lines and then redistribute to get desired income distribution. The critics counter the neo-classical policy, arguing that initial arrangements of production are dominating determinant of the income distribution as well as redistribution are technically difficult and politically implausible in the later. These critics also dismiss the arguments that redistributive tools are too distortionary.

The main theoretical debate in recent time has been between neo-classical and structuralist schools, both of which stress tangible inputs and constraints to growth. The former paradigm extols the virtues of the free markets, while the latter emphasises various market failures that are supposedly widespread in the developing context. However, policy failures have led to a revival of market –based approaches combined with an outward orientation. Newer heterodox theories, by contrast, go beyond tangible factors to stress intangible elements such as social organisation, culture and institutions that constrain development. Most prominent among these is political economy which holds that development could be impeded by the interplay of groups that advance their self interest, over the national interest.

The Meaning of Development

It is daunting, if not impossible, to provide a precise meaning to the term *economic development*. 'Development', on the face of it is a neutral sounding word. The intellectually stimulating word is momentous and current as well as moves beyond walls of a discipline. It is intuitively said that economic progress is an essential component of development, but is not purely an economic phenomenon. It captures more than the material and financial facets of people's lives -- it could be treated as a *multidimensional process.*

According to some economists, 'development' is a normative term and thus it is finding out of necessary conditions. Professor Dudly Seers (1969),[1] a proponent of this school of thought, traces out meaning of development:

> "The questions to ask about a country's development are therefore: What has been happening to poverty? What has been happening to unemployment? What has been happening to inequality? If all three of these have declined from high levels, then beyond doubt this has been a period of development for a country concerned. If one or two of these central problems have been getting worse, especially if all three have, it would be strange to call the result 'development' even if per capita income doubled."

Given the limitations of traditional approaches, Nobel laureate Amartya Sen has elaborated a series of formal proposals for moving the economics agenda forward – beyond 'welfarism' – and for expanding the types of variables and influences that are accommodated in theoretical and empirical economics. This critique has challenged the equation of rational behaviour with self-interested utility maximisation; the use of self-interested utility maximisation as a predictor of individual behaviour; and the use of choice information as an indicator of individual preference and value. It has highlighted the limitations of utility information as a basis for evaluating and comparing human interests, and of utility-based interpretations of economic efficiency and social optimality – as reflected in standard approaches to 'Pareto Efficiency' and the 'Fundamental Theorems of Welfare Economics.' His contributions include far-reaching proposals for incorporating individual entitlements, functioning, opportunities, and capabilities, freedoms and rights into the conceptual foundations and technical apparatus of economics and social choice.

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[1] Dudley Seers, "The Meaning of Development" *International Development Review,* Vol. XI, No. 4, pp 2-6, 1969.

Concept	Past approaches	New approaches
Individual interests/ advantage/ well-being	Income/ Consumption/ Utility (i.e. Individual happiness and/or desire fulfillment)	Human capabilities and opportunities – with an explicit role for freedom, agency and rights
Food security	National food availability	The food entitlements of individuals and groups
Poverty	Deprivation in income/ consumption/expenditure	Deprivation in human capabilities such as knowledge, longevity and living standards (e.g. access to water and services) – more emphasis on self-reporting, self-esteem, participation and empowerment
Ultimate ends of development	Economic efficiency/ Maximisation of GDP per capita	Human development and 'development as freedom' – the expansion of valuable capabilities and the realization of freedoms and human rights

Sen's 'entitlement approach' provides a framework for analysing the relationship between rights, interpersonal obligations and individual entitlement to things. A person's entitlement set is a way of characterising his or her 'overall command over things' taking note of all relevant rights and obligations. Whereas rights are generally characterised as relationships that hold between distinct agents (e.g. between one person and another person, or one person and the state), a person's entitlements 'are the totality of things he can have by virtue of his rights'. Sen has hypothesised that 'most cases of starvation and famines across the world arise not from people being deprived of things to which they are entitled, but from people not being entitled, in the prevailing legal system of institutional rights, to adequate means for survival'.

Sen's concept of functioning relates to the things a person may value doing or being. Functioning are features of a person's state of existence ranging from relatively elementary states (e.g. being adequately nourished), to complex personal states and activities (e.g. participation and appearing without shame).
The concept of capability relates to the ability of a person to achieve different combinations of functioning – the various combinations of valuable beings and doings that are within a person's reach, reflecting the opportunity or freedom to choose a life that a person values. Sen's empirical research has highlighted the possibility of divergences between the expansion of economic growth and income on the one hand, and the expansion of valuable human capabilities on the other.

Sen has advocated new approaches to thinking about fundamental freedoms and human rights. In the past, poverty and hunger were often excluded from dominant discourses on fundamental freedoms and human rights. Sen has challenged this approach, arguing that: 'When we assess inequalities across the world in being able to avoid preventable morbidity, or escapable hunger, or premature mortality, we are not merely examining differences in well-being. The available data regarding the realisation of disease, hunger, and early mortality tell us a great deal about the presence or absence of certain central basic freedoms' (1992, 69).[2]

An agenda for the New Development Economics[3]

Stiglitz, J (1999) discusses limitations of the competitive equilibrium model and suggests that it provides an inadequate model of developed countries, and therefore a poor starting point for the construction of a model for developing economies. He asserts that development needs to be seen from a new perspective, as a transformation of society, not just an increase in physical and human capital. The new development research agenda needs to focus on:

- identifying and explaining key characteristics of developing countries, and especially those that differentiate them from the more developed countries, and exploring the macro-economic implications, e.g. for growth and stability
- describing the process of change, how institutions, including social and political institutions, and economic structures are altered in the process of development. This includes analysing reform processes: how can those wishing to effect certain changes bring those changes about, and what are the impediments in doing so.
- looking at macro-instability, both how to reduce its depth and frequency and how to respond to the downturns and crises that seem to occur with such frequency. It is now recognized that many of the Washington consensus policies that were foisted on developing countries, did little to increase economic growth, and may have contributed significantly to economic instability. This includes issues related to governance and corruption

[2] Sen, A. K. (1992) *Inequality Reexamined.* Oxford: Clarendon..
[3] Stiglitz, J (1999), "Participation and Development:Perspectives from the Comprehensive Development Paradigm," Remarks at the International Conference on Democracy, Market Economy and Development, Seoul, Korea, February 27, 1999

Review Questions

Multiple Choice Questions

1. The main theoretical debate in recent time has been between:
   A. Neo-classical and structuralist schools.
   B. Classical and Marxists
   C. Neo-classical and dependency theorists
   D. Marxists and Neo-liberals

2. The Neo-classical paradigm extols the virtues of:
   A. Market failures
   B. Free markets,
   C. Mixed economies
   D. Welfare state

3. A person's entitlement set is a way of characterising his or her:
   A. State of existence ranging from relatively elementary states.
   B. The various combinations of valuable beings and doings that are within a person's reach, reflecting the opportunity or freedom to choose a life that a person values.
   C. 'Overall command over things' taking note of all relevant rights and obligations.
   D. Possibility of divergences between the expansion of economic growth and income on the one hand, and the expansion of valuable human capabilities on the other.
4. The concept of capability relates to:
   A. The relationship between rights, interpersonal obligations and individual entitlement to things
   B. Things a person may value doing or being.
   C. His or her 'overall command over things'
   D. The ability of a person to achieve different combinations of functioning

Answers: 1. A; 2. B; 3.C and 4.D

Short Questions

1. Do you think that emergence of development economics was inevitable?
2. What is your opinion as regards meaning of development?
3. What are the salient features of Sen's framework?
4. What differences did Hirschman point out as regards goals of development economics?
5. Suggest briefly an agenda for new development economics.

Essay-type Questions

1. Policy failures have led to a revival of market –based approaches combined with an outward orientation.
2. “Development could be impeded by the interplay of groups that advance their self interest, over the national interest,” Discuss.
3. The disagreements between Neo-classical and Structuralists originate about the assumption of theory and rejection of the implications of the policies – analyse.
4. “Possibly the most important normative objection to neo-classical economics arises from fears of adverse distribution consequence that may flow from it.”

Further reading

1. Sen, A. K. (1981*) Poverty and Famines: An Essay on Entitlement and*
2. *Deprivation*. Oxford: Clarendon.
3. Sen, A. K. (1984) ‘Rights and Capabilities’. *Resources, Values and*
4. *Development.* A. K. Sen. Oxford: Blackwell.
5. Sen, A. K. (1984b) ‘The Right Not To Be Hungry’. *Contemporary*
6. *Philosophy: A New Survey, Volume 2*. G. Fløistad (1982). The Hague:
7. Martinus Nijoff.
8. Sen, A. K. (1987) *On Ethics and Economics.* Oxford: Blackwell.
9. Sen, A. K. (1992) *Inequality Reexamined.* Oxford: Clarendon.
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12. *East Asian Challenge for Human Rights*. J. R. Bauer and D. A. Bell.
13. Cambridge: CUP.
14. Sen, A.K. (2000) ‘Consequential Evaluations and Practical Reason’,
15. *Journal of Philosophy*, xcvii (9).
16. Stiglitz, Joseph E (2001) *An Agenda for the New Development*
17. *Economics,* Draft paper prepared for the discussion at the UNRISD meeting on “The Need to Rethink Development Economics”, 7-8 September 2001, Cape Town, South Africa.
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19. *Human Development*, New York: OUP.
20. World Bank (2000) *World Development Report 2000-01: Attacking Poverty*.
21. Oxford: OUP.

LESSON 2: CHARACTERISTICS OF DEVELOPING COUNTRIES

Objectives

A proper understanding on the development requires a thorough comprehension of the characteristics of developing countries. It is equally important to grasp the magnitude of the underdevelopment as also the obstacles these countries are up against in getting out of their present state.

After studying this lesson, you will be able to:

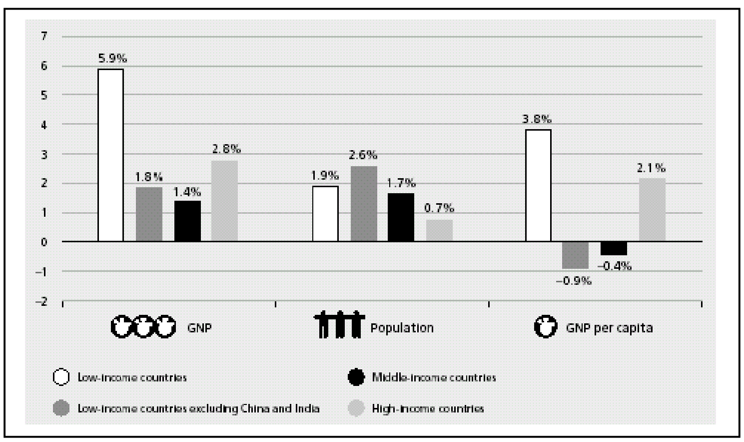
- Know the basic elements of developing countries.
- Spotlight its identity, its various facets that together focus on its characteristics.

Major Economic Indicators of the Least Development Countries

Average Growth of GNP, Population and Per Capita GNP

Low-income countries, by contrast, appear to have performed much better during the 1980s and in the first half of the 1990s, with GNP growing by almost 6 percent a year in 1980-95. So, will the poor countries soon catch up with the rich? The economic growth patterns described above do not mean that the world is on its way to "convergence"- that is, to the gradual elimination of the economic gap between rich and poor countries. Much faster population growth in most developing countries is offsetting comparatively faster GNP growth, causing GNP per capita growth rates in these countries to be low or even negative.

Average Growth of GNP, Population and Per Capita GNP, 1980-1995

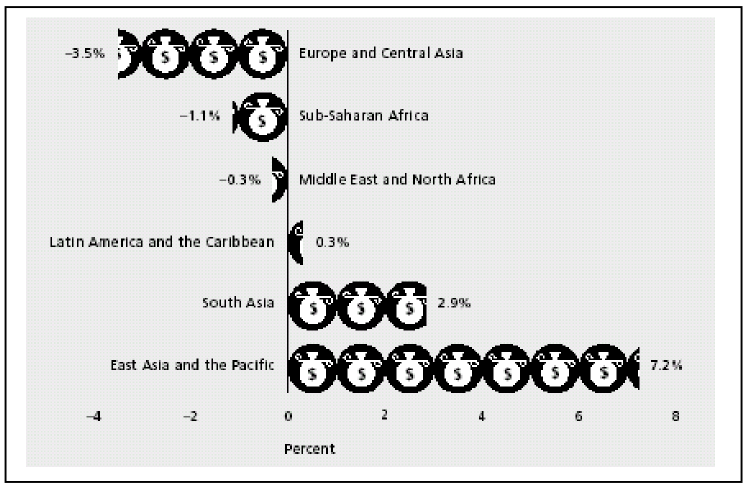


Source: Soubbotina, T. P. and K. A. Sheram, *Beyond Economic Growth*, Washington: World Bank, 2000

As a result the gulf between the average GNP per capita in developing and developed countries continues to widen. According to a World Bank study, per capita income in the richest countries was 11 times greater than in the poorest countries in 1870, 38 times greater in 1960, and 52 times greater in 1985. In the early 1990s, of $23 trillion in global GDP, only $5 trillion- less than 20 percent- was generated in developing countries- even though these countries accounted for about 80 percent of the world's population.

The rapid average growth in developing countries also masks growing disparities among these countries. Between 1985 and 1995 East Asia experienced the fastest growth of GNP per capita- more than 7 percent a year. But in two other regions of the developing world, the average annual growth rate was negative: -1.1 percent in Sub-Saharan Africa, and -0.3 percent in the Middle East and North Africa. The biggest drop in GNP per capita growth occurred in Eastern Europe and Central Asia because of the economic crisis caused by the transition from planned to market economies

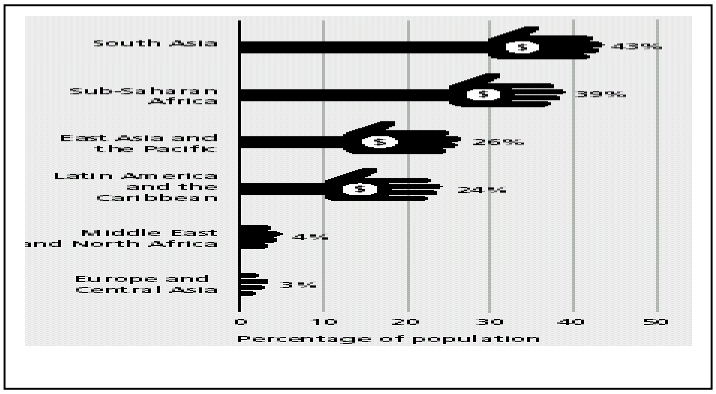
Average Annual per capita GNP Growth Rates, 1980-1995



Source: Soubbotina, T. P. and K. A. Sheram, *Beyond Economic Growth*, Washington: World Bank, 2000

Between 1965 and 1995 the gap between developed countries and most developing countries widened considerably. Asia was the only major region to achieve significant convergence toward developed countries' level of GNP per capita. Per capita income in the newly industrialized economies of Asia- Hong Kong (China), the Republic of Korea, Singapore, and Taiwan (China) - increased from 18 percent of the developed countries' average in 1965 to 66 percent in 1995. At the same time Africa, for instance, became even poorer in relative terms. The average per capita income in African countries equaled 14 percent of the developed countries' level in 1965 and just 7 percent in 1995.

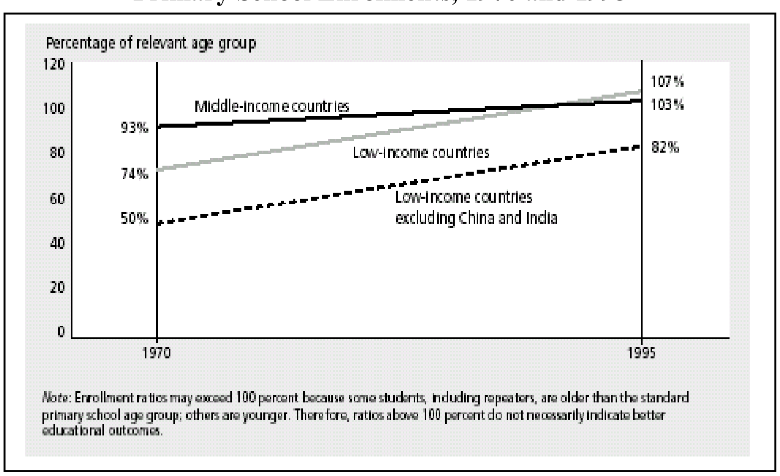
Population Living less than a Dollar day, 1993



Primary Education and Literacy

Despite rapid growth in the number of children of primary school age, since 1970 developing countries have succeeded in sharply increasing the percentage of children enrolled in primary school. But universal primary education, a goal being pursued by most governments of developing countries, is still far from being achieved in many of them. Low enrolments in many low-income countries may signal inadequacies in education system capacity as well as social conditions that prevent children from enrolling.

Primary School Enrolments, 1970 and 1995

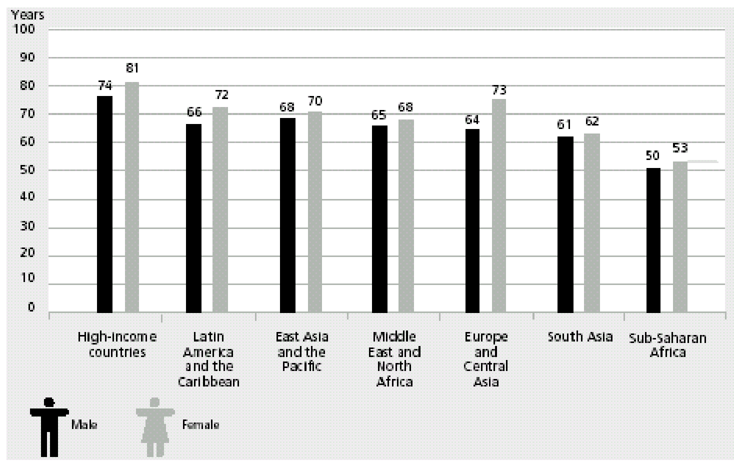


Source: Soubbotina, T. P. and K. A. Sheram, *Beyond Economic Growth*, Washington: World Bank, 2000

Life expectancy at birth

During the second half of the 20th century health conditions around the world improved more than in all previous human history. Average life expectancy at birth in low- and middle-income countries increased from 40 years in 1950 to 65 years in 1996. Over the same period the average under-5 mortality rate for this group of countries fell from 280 to 80 per 1,000. But these achievements are still considerably below those in high-income countries, where average life expectancy at birth is 77 years and the average under- 5 mortality rate is 7 per 1,000.

Life Expectancy at Birth, 1995



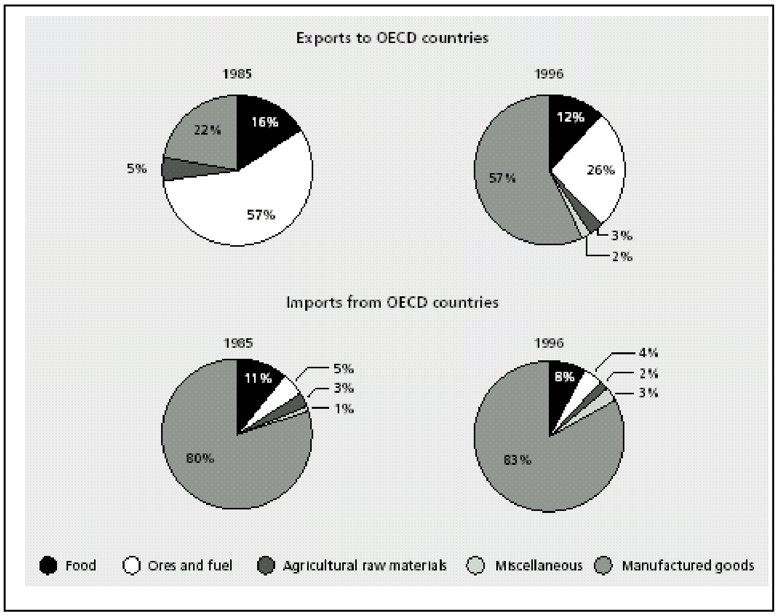
Source: Soubbotina, T. P. and K. A. Sheram, *Beyond Economic Growth*, Washington: World Bank, 2000

Geography and Composition of Global Trade

Over the past 10 years patterns of international trade have been changing in favour of trade between developed and developing countries. Developed countries still trade mostly among themselves, but the share of their exports going to developing countries grew from 20 percent in 1985 to 22 percent in 1995. In the same time, developing countries have increased trade among themselves. Still, developed countries remain their main trading partners, the best markets for their exports, and the main source of their imports. Most developing countries' terms of trade deteriorated in the 1980s and 1990s because prices of primary goods- which used to make up the largest share of developing country exports- have fallen relative to prices of manufactured goods. For example, between 1980 and 1995 real prices of oil dropped almost fourfold, prices of cocoa almost threefold, and prices of coffee about twofold. There is still debate about whether this relative decline in commodity prices is permanent or transitory, but developing countries that depend on these exports have already suffered heavy economic losses that have slowed their economic growth and development.

In response to these changes in their terms of trade, many developing countries are increasing the share of manufactured goods in their exports, including exports to developed countries. The most dynamic categories of their manufactured exports are labour-intensive, low-knowledge products (clothes, carpets, some manually assembled products) that allow these countries to create more jobs and make better use of their abundant labour resources.

Developing Countries' Trade with OECD Countries, 1985 and 1995



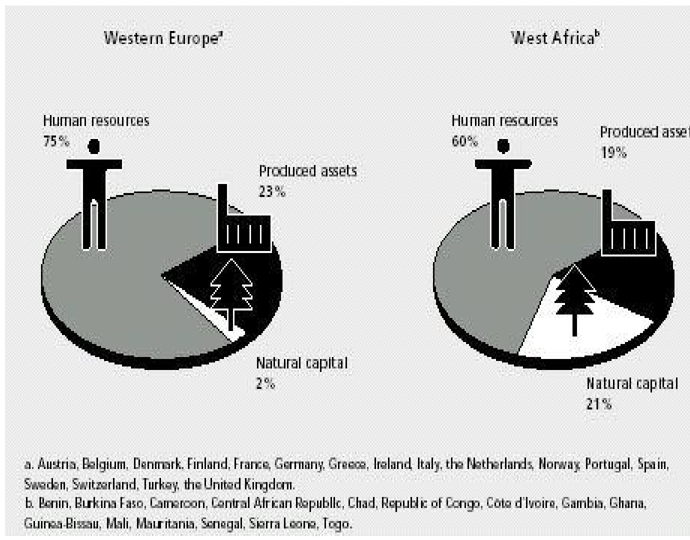
Source: Soubbotina, T. P. and K. A. Sheram, *Beyond Economic Growth*, Washington: World Bank, 2000

Composition of National Wealth

According to a number of recent World Bank studies, physical capital (produced assets) is not the main- much less the only- component of a country's wealth. Most important for all countries are human resources, which consist of "raw labour," determined mainly by the number of people in a country's labour force, and human capital. Natural capital is another important component of every nation's wealth.

A country's level of development determines the roles played by the different components of its national wealth. The dominance of human capital is particularly marked in the most developed countries, where natural capital accounts for just 2-5 percent of aggregate wealth. By contrast, in West Africa- one of the world's poorest regions- natural capital still prevails over physical capital, and the share of human resources is among the lowest in the world despite a large population. Comparing West Africa to Western Europe is particularly indicative because in absolute terms the two regions have roughly the same per capita value for natural capital. Thus the striking difference in the composition of their national wealth can be entirely attributed to the fact that the average West European has 13-14 times as much human and physical capital at his or her disposal.

Composition of National Wealth

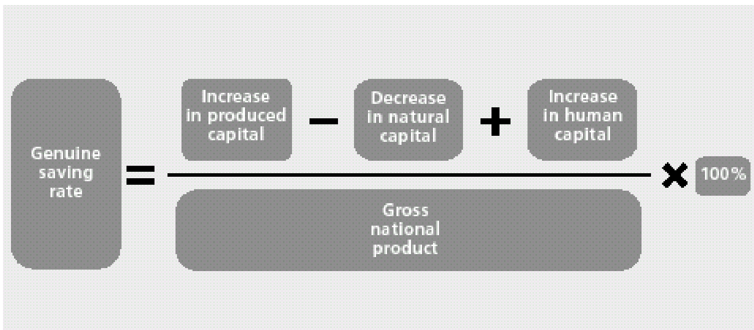


Accumulation of National Wealth as an Indicator of Sustainable Development

Over the past 10 years the concept of sustainable development has become more comprehensive and measurable. A recent World Bank study defined sustainable development as "a process of managing a portfolio of assets to preserve and enhance the opportunities people face." The assets that this definition refers to include not just traditionally accounted physical capital, but also natural and human capital. To be sustainable, development must provide for all these assets to grow over time- or at least not to decrease. The same logic applies to prudent management of a national economy as applies to prudent management of personal property.

With that definition in mind, the main indicator of sustainable (or unsustainable) development might be the "genuine saving rate" or "genuine investment rate," a new statistical indicator being developed by World Bank experts. Standard measures of wealth accumulation ignore the depletion of, and damage to, natural resources such as forests and oil deposits, on the one hand, and investment in one of a nation's most valuable assets- its people- on the other. The genuine saving (investment) rate is designed to correct for this shortcoming by adjusting the traditional saving rate downward by an estimate of natural resource depletion and pollution damages (the loss of natural capital), and upward by growth in the value of human capital (which comes primarily from investing in education and basic health services)

Calculating the Genuine Savings Rate

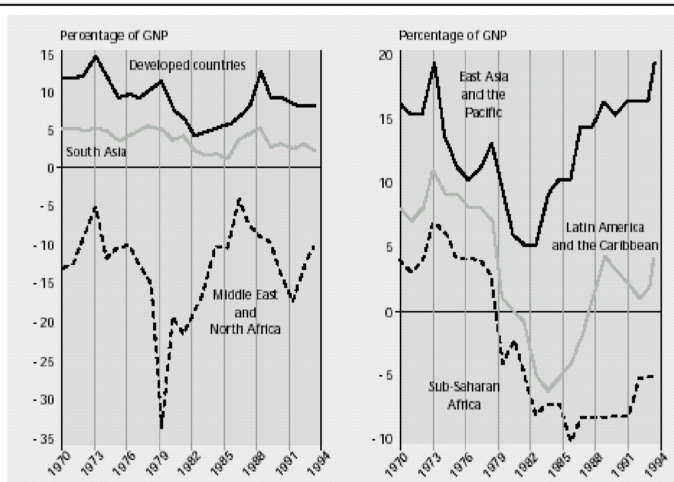


Source: Soubbotina, T. P. and K. A. Sheram, *Beyond Economic Growth*, Washington: World Bank, 2000

Calculating genuine saving rates for different countries is extremely challenging, particularly because of difficulties in valuing human capital. But the effort is considered worthwhile because of the potential importance of sustainable development indicators for informing and guiding practical policymaking.

World Bank analysis has already shown that many of the most resource-dependent countries seem to have low or negative genuine saving. This will eventually lead to declining well-being of their citizens if no consistent efforts are made to reverse the trend. The only two "safe" regions of the developing world appear to be South Asia and East Asia and the Pacific, where genuine saving rates in 1970-93 were positive and sometimes topped 15 percent of GNP. In developed countries the rates of genuine saving were near 10 percent for much of that period.

Genuine Savings Rate, estimates for 1970 – 1993



Source: Soubbotina, T. P. and K. A. Sheram, *Beyond Economic Growth*, Washington: World Bank, 2000

Review Questions

Multiple Choice Questions

1. The rate of economic growth is high amongst
    - A. low-income economies
    - B. newly industrialised countries
    - C. advanced industrialised countries
    - D. SAARC countries.

2. The concentration of developing countries' trade is with
    - A. OECD
    - B. European Union
    - C. Developing countries.
    - D. G-8 countries.

Answers: 1.B, 2.A

Short Questions

1. Write a note on the definition of sustainable development.
2. How do you calculate genuine savings rate?

Broad Questions

1. The higher economic growth patterns achieved by developing countries in comparison developed countries mean that the world is on its way to "convergence"- Discuss.
2. What are the factors, according to you, perpetuate underdevelopment?

Further Readings

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2. Hunt Diana, *Economic Theory of Development: An Analysis of competing Paradigm*, University of Sussex, Harvester Wheatsheaf, 1989.
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6. *Hand Book of Development Economics*