Manonmaniam Sundaranar University

Directorate of Distance and Continuing Education

Tirunelveli - 627012, TamilNadu.

B.A.ECONOMICS

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DEVELOPMENT ECONOMICS (JMEC62)

Compiled by

Dr.R.Iyappan

Assistant Professor of Economics
Manonmaniam Sundaranar University
Tirunelveli – 627 012.

DEVELOPMENT ECONOMICS	
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UNIT – I

INTRODUCTION

Development economics is the branch of economics that studies the economic and social progress of developing countries, focusing on improving fiscal, economic, and social conditions for their populations. Its nature is interdisciplinary, as it goes beyond simple growth to analyze structural transformations, poverty, inequality, human capital, and the role of institutions, incorporating social and political factors to create practical policies.

MEANING

- **Goal**: To understand how low-income economies can improve their economic, fiscal, and social conditions to become high-income nations.
- **Scope**: It examines issues such as poverty, inequality, and human capital formation to raise the overall quality of life, not just per capita income.
- **Focus**: It analyzes the economic aspects of a low-income country, including healthcare, education, and labor conditions, to help them overcome hurdles to growth.

NATURE

- **Interdisciplinary**: Development economics often incorporates social and political factors into its analysis, unlike many other fields of economics.
- **Transformational**: It studies the structural transformation of an economy from an agrarian, rural, and low-skill base to an urban, modern, and high-skill one.
- **Policy-oriented**: It is concerned with creating and implementing policies at both the domestic and international levels to facilitate development.
- **Holistic**: It includes the creation of theories and methods to address a wide range of issues, from macro-level growth theory to micro-level project analysis, and incorporates both quantitative and qualitative methods.

CORE VALUES OF DEVELOPMENT

The three core values of development are sustenance, self-esteem, and freedom. Sustenance refers to meeting the basic needs of life, such as food, shelter, and health. Self-esteem involves a sense of worth and dignity, while freedom means having the ability to make choices and being free from servitude, oppression, and exploitation.

1. **Sustenance:** This is the ability to meet the basic needs of life, including food, shelter, health, and protection. Development must ensure that these fundamental necessities are available to everyone.
2. **Self-esteem:** This refers to a sense of personal worth and self-respect. It includes feeling that one is not marginalized and that one's dignity and identity are respected, which can be based on a variety of factors like material success, intellect, or public service.
3. **Freedom:** This is the ability to make choices and control one's own life. It includes freedom from servitude, exploitative relationships, and oppressive social or political systems. Freedom also involves a range of choices in both economic and political spheres.

AMARTYA SEN'S APPROACH TO DEVELOPMENT

Amartya Sen's approach to development emphasizes the expansion of people's real freedoms and capabilities, defining development as the process of enhancing the ability to live a life one values. Moving beyond income and economic growth, this capability approach considers factors like health, education, political participation, and security as crucial for human well-being and freedom.

Core Concepts

- **Capabilities:** These are the substantive freedoms people have to achieve valuable 'doings' (actions) and 'beings' (states of existence). Examples include being healthy, being educated, or participating in community life.

- **Functionings:** These are the actual achievements of a person's capabilities. For instance, if someone has the capability for education, their functioning might be being literate.
- **Conversion Factors:** These are internal and external factors that affect a person's ability to convert resources into capabilities and functionings. These include personal characteristics (e.g., disabilities), environmental conditions, and social norms.

Key Tenets

- **Beyond Economic Growth:** Development should not be measured solely by income or GDP, but by the expansion of human capabilities.
- **Focus on Freedom:** Human freedom is both the means and the end of development, encompassing various aspects like economic and political freedoms.
- **Individual Well-being:** The approach focuses on what people can do and be, recognizing individual diversity and the social context that influences these capabilities.
- **Abolishing "Unfreedoms":** Development involves actively working to eliminate barriers to freedom, such as poverty, tyranny, lack of access to education and healthcare, and neglect of public facilities.

Significance

Sen's framework offers a more comprehensive understanding of development by integrating ethical considerations with economic analysis. It has been instrumental in developing the Human Development Index (HDI) and other tools that assess human well-being beyond economic indicators.

ECONOMIC GROWTH VS ECONOMIC DEVELOPMENT

Economic growth is the increase in a nation's production of goods and services, measured by metrics like GDP. Economic development is a broader concept that includes growth but also encompasses improvements in quality of life, such as better health, education, and living standards. Growth is quantitative, while development is both quantitative and qualitative.

Economic growth

- **Definition**: An increase in the production of goods and services in an economy over time.
- **Focus**: Quantitative and one-dimensional, focusing primarily on income and output.
- **Measurement**: Typically measured by metrics like Gross Domestic Product (GDP), per capita income, and industrial output.
- **Relation to development**: It is a necessary but not sufficient condition for economic development. A country can have growth without development.

Economic development

- **Definition**: A broader and more comprehensive measure of progress that includes economic growth plus improvements in the well-being and quality of life of its citizens.
- **Focus**: Qualitative and multidimensional, considering income, social welfare, and other aspects of life.
- **Measurement**: Measured by indicators like life expectancy, literacy rates, infant mortality rates, poverty reduction, and the Human Development Index (HDI).
- **Relation to growth**: Economic development is a broader concept that includes economic growth. It cannot be achieved without growth, but it goes beyond it by addressing issues like income inequality and access to services.

Points geteconhelp.com	Economic Growth	Economic Development
Meaning	Economic growth refers to the raise in the value everything produced within the economy.	Economic development is process of rise in real national income due to structural changes for a long period.
Scope	The scope of economic growth is narrow compared to scope of economic development.	The scope economic development is broader compare to concept of economic growth.
Indicators	The economic growth is indicated by increase in GDP or GNP. Growth relates to a gradual increase in one of the components of Gross Domestic Product: consumption, government spending, investment and net exports.	The economic development is indicated by improvement in life expectancy, human development etc. Development relates to growth of human capital indexes, a decrease in inequality of income and wealth and structural changes that improve the quality of life of people.
Measurement	In order to measure economic growth, one can consider change in real GDP and GNP.	In order to measure economic development, PQLI, HDI and HPI are used.
Nature	Economic growth is the resultant effect or an occurrence.	Economic development is a process.
Country	The concept of economic growth is generally used by developing country like India.	The concept of economic development is generally used by developed country like UK and USA.
Reflect	Economic growth is quantitative change which reflects rise in national income.	Economic development is qualitative change which not only emphasis on rise in national and per capita income but also on distribution of income.
Process	Economic growth is rapid process.	Economic development is slow process.
Possible	Economic growth is possible without economic development.	Economic development is not possible without economic growth.

PROGRESS AND ECONOMIC WELFARE

Economic progress is the improvement in economic welfare, which is a broader measure of well-being that includes factors beyond income, such as health, education, and equality. While economic growth focuses on increases in a country's total output (like GDP), economic welfare considers the quality of life, including access to goods and services, health outcomes, education levels, and income equality.

Economic growth vs. economic welfare

1. **Economic growth:** This is a narrower concept, often measured by the increase in real national income or GDP. It reflects a country's increased productive capacity but doesn't account for how the benefits are distributed or the social and environmental impacts.
2. **Economic welfare:** This is a more comprehensive measure of a society's well-being. It includes:
    a) **Income and wealth:** The overall availability of goods and services and how income and wealth are distributed.
    b) **Health and education:** Improvements in health outcomes and access to education are crucial components of welfare.
    c) **Security:** A feeling of security for individuals and their families.
    d) **Other factors:** It can also include aspects like environmental quality, equality, and subjective feelings of well-being.

Relationship between progress and welfare

1. **Economic growth is a necessary but not sufficient condition for economic welfare.** Growth can provide the resources to improve welfare, but it does not automatically lead to it.
2. **Improvements in welfare can be limited by factors ignored by growth metrics.** For example, a growing GDP might not improve welfare if it leads to increased inequality, environmental damage, or a decrease in health and education outcomes.

3. **A focus on economic welfare requires a broader approach to policy and measurement.** This involves looking beyond simple economic indicators like GDP to include social and environmental factors, and using more holistic metrics to evaluate progress.

COMPARATIVE ECONOMIC DEVELOPMENT

Comparative economic development is the study of different national development paths to understand why some countries grow faster or differently than others. It compares various approaches, institutions, historical legacies, and geographical factors that shape economic outcomes, using frameworks that analyze agricultural transformation, industrialization processes, and the role of the state. Key elements studied include human capital, trade policies, investment, and long-term influences like post-colonial institutions and geography.

Key Aspects Studied

1. **Historical Trajectories:** Analyzing diverse historical paths of growth and transition to industrialization, such as those followed by Britain, Japan, and the USSR.
2. **Role of the State:** Examining how government policies and interventions affect economic development and industrial transitions.
3. **Agricultural Transformation:** Investigating the role of agricultural surplus and agrarian relations in fostering industrial development.
4. **Industrialization Process:** Studying the creation of the factory system and the emergence of the industrial working class in different national contexts.
5. **Institutional Factors:** Analyzing the long-term impact of institutions, including property rights, the rule of law, and the effectiveness of civil society, which were often shaped by colonial legacies.
6. **Geographical and Environmental Factors:** Considering the influence of geography, such as access to ports, the burden of diseases like malaria, and resource endowments, on economic growth.

Common Themes and Characteristics

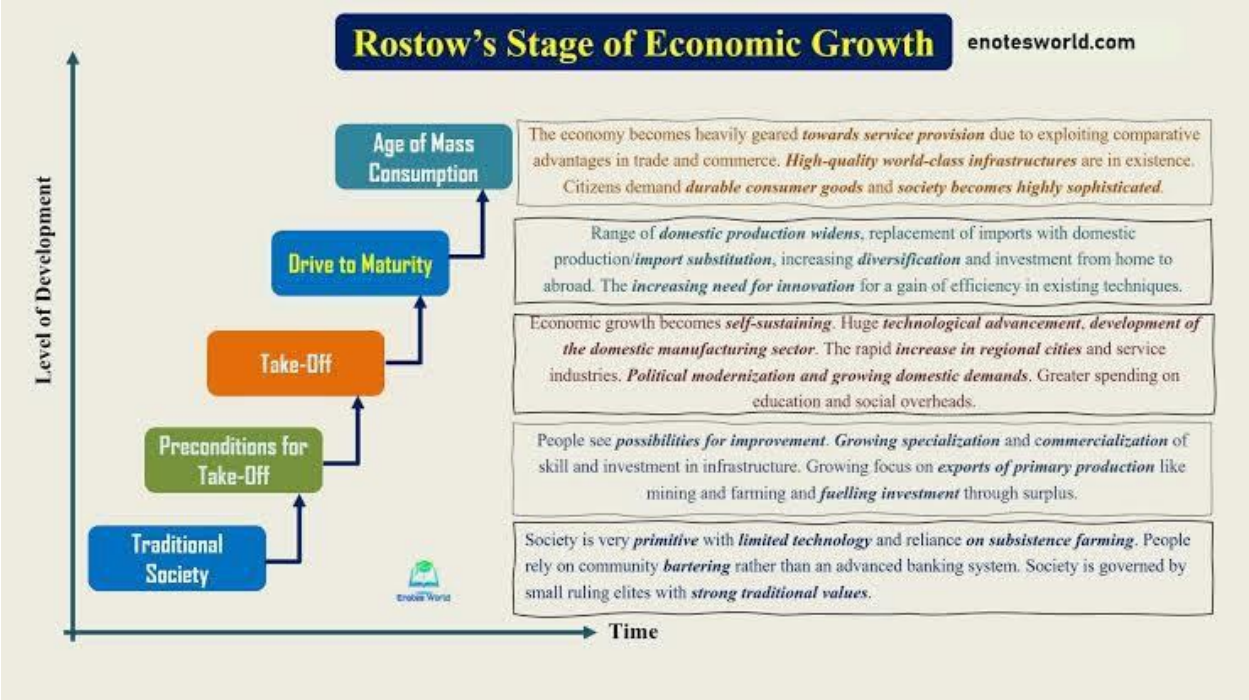
1. **Developing vs. Developed Countries:** Comparative economic development often contrasts common features of less developed countries, such as lower living standards and higher poverty, with characteristics of advanced economies.
2. **Factors Stimulating Growth:** Key growth drivers identified include investment in human capital, adoption of open trade policies, and closing knowledge gaps.
3. **Institutional Quality:** Research suggests that post-colonial institutions play a critical role in fostering well-functioning markets, public goods like education and health, and effective civil societies, all of which support development.

Methods of Comparison

1. **Case Studies:** In-depth studies of specific countries (e.g., Britain, Japan, China, India) to understand their unique development experiences.
2. **Comparative Systems Analysis:** Comparing different economic systems (capitalism, socialism, mixed economies) and their performance using metrics like GDP.

UNIT – II

ROSTOW'S STAGES OF ECONOMIC GROWTH



Rostow's stages of economic growth is a theory that proposes that all countries go through five linear stages of development: traditional society, preconditions for take-off, take-off, drive to maturity, and age of high mass consumption. This model, proposed by W.W. Rostow, suggests that development occurs as a country industrializes, moving from a static, agricultural economy to one driven by manufacturing and then by consumer demand.

The five stages of economic growth

1. **Stage 1: Traditional Society:** This society has limited technology, a large agricultural base, and a rigid social structure. Economic growth is minimal due to technological and social limitations.
2. **Stage 2: Preconditions for Take-off:** External influences, such as new markets, lead to increased investment in infrastructure, commerce, and agriculture. A new social and political framework emerges, which sets the stage for more rapid growth.

3. **Stage 3: Take-off:** This is a period of rapid industrialization and economic growth. Manufacturing industries develop, and new elites emerge. Investment in the economy surpasses 10% of national income.
4. **Stage 4: Drive to Maturity:** The economy diversifies beyond its initial leading sectors. Investment remains high, and a wide range of modern industries develop. Economic growth becomes self-sustaining and the country's potential for development is fully realized.
5. **Stage 5: Age of High Mass Consumption:** This is the stage of a developed economy where a high level of consumption occurs. The country's comparative advantages are exploited in international trade, and consumer durable industries flourish. The standard of living rises significantly as a result of increased wages and economic welfare.

BIG PUSH THEORY

The "big push" theory, introduced by economist P.N. Rosenstein-Rodan, proposes that developing countries need a large, coordinated, and simultaneous investment in multiple sectors to overcome a vicious cycle of poverty. This "big push" of investment in areas like infrastructure, human capital, and industry is necessary to generate external economies and break the inertia that keeps a stagnant economy from developing. Without this coordinated and large-scale effort, individual, small-scale investments are seen as ineffective and a waste of resources.

Key components of the "big push" theory

1. **Indivisibilities:** The theory is built on three main types of indivisibilities that create a need for coordinated investment:
    a. **Production function:** Capital investment is "lumpy," meaning that certain basic infrastructure, like roads or power grids, must be built before other industries can develop efficiently.
    b. **Demand:** The small size of underdeveloped economies means individual firms cannot guarantee a market for their products. Simultaneous investment in multiple complementary industries can create a larger market and ensure demand for everyone's products.

c. **Savings:** Income and savings are both too low for individual investments to be large enough. A "big push" can increase incomes sufficiently to generate the necessary savings for a self-sustaining growth process.

2. **Coordinated investment:** Investments must be made simultaneously across different sectors, such as infrastructure, industry, and social overhead capital (like education and healthcare).
3. **External economies:** The coordinated investment creates external economies, which are benefits like lower costs or increased productivity that are shared across multiple industries, thus driving overall growth.

Criticisms of the theory

- **Neglect of agriculture:** The theory focuses heavily on industrial development and infrastructure, potentially neglecting the importance of investing in the agricultural sector, which is often a major part of developing economies.
- **Inflationary pressure:** A large-scale investment funded by printing new money or foreign loans could lead to inflation.
- **Administrative and institutional difficulties:** Developing countries may face issues like corruption and ineffective state machinery, making it difficult to implement the coordinated investment plan effectively.
- **Lack of historical evidence:** Some argue that the theory lacks a strong basis in historical evidence and is more of a prescriptive recipe than an empirically proven model.

THEORY OF CRITICAL MINIMUM EFFORT

The theory of critical minimum effort, proposed by Harvey Leibenstein, argues that underdeveloped countries need a significant, large-scale investment—the "critical minimum effort"—to escape the cycle of poverty. This investment is necessary to make the "stimulants" (income-generating forces) more powerful than the "shocks" (income-depressing forces like

overpopulation). Without this large initial push, the economy will remain stuck in a low-level equilibrium where any small income gains are canceled out by the stronger negative shocks.

Diagrammatic Representation:

The theory of critical minimum effort has been illustrated in Figure 1.

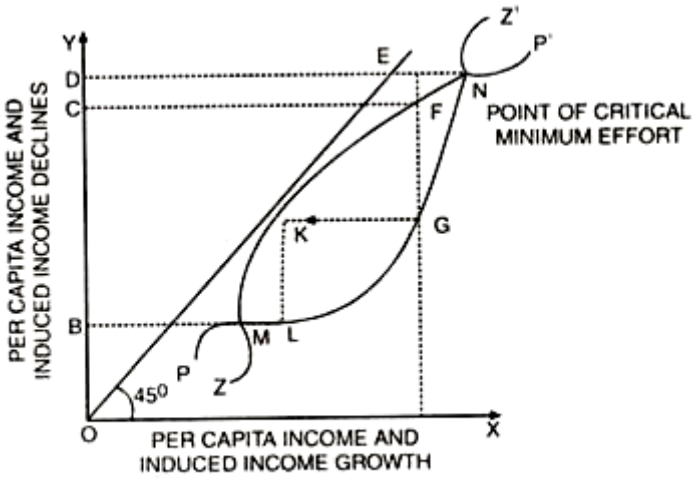


Fig. 1.

The diagram shows the outcome of the struggle between the stimulants and shocks and also enables to find out stimulants of sufficient magnitude as below:

(i) OX-axis of the diagram represents per capita income and induced income growth.

(ii) OY-axis indicates per capita income and induced income declines.

(iii) The 45 ° line measures induced increases and decreases in income.

(iv) P' curve represents stimulants and Z' curve shows stocks.

(v) OM is the subsistence living standard.

(vi) At M' curve P' Z' intersect each other indicating the equality between growth rate of population and the growth rate of income so that the income is caught in the vicious circle of poverty.

(vii) If the income level is raised from OB to OC which is not in accordance with the critical minimum effort, the rising population will neutralize the increased income. The system will once again hand on the subsistence level of living. Shocks being more powerful than the stimulants. At OJ level of income raising forces are just FE while the depressants up to GM. This will bring the income level down to M again which is just the subsistence level.

(viii) Solution of this problem for such a rise in the level of national income where stimulants are stronger than the shocks so that the growth in income becomes self-sustaining.

(ix) If the per capita income is raised beyond OD' the economy, can be pulled out of the vicious circle of poverty. Thereby, growth in income becomes self-sustaining beyond point D. The per capita income has been shown by the arrows.

Attitudes, Motivation and Incentives:

According to Leibenstein, the generation of stimulants depends on attitudes and motivation of the people and the incentives given to them. However, the motivation and incentives are useless without the main factors of economic development. The main factors of economic development are the entrepreneurs, the inventors, the discoverers, the innovators, and those who can accumulate and utilize wealth, and those who can accumulate skills and spread knowledge.

No doubt the activities of such persons are endless, but we are to study only those activities which are in a position to generate stimulants and promote economic growth. It requires continuous efforts of various agencies necessary for economic development. It requires special type of human response to attitudes, motivations and incentives which are created by economic and social environment.

Key concepts

- **Vicious circle of poverty:** Leibenstein's theory is based on the idea that poverty-stricken countries are trapped in a cycle where low income, low savings, and low investment reinforce each other.

- **Shocks:** These are forces that decrease per capita income. They are prevalent in underdeveloped countries and include factors like overpopulation, outdated technology, and lack of skills.
- **Stimulants:** These are forces that increase per capita income, such as advanced technology, proper infrastructure, and education.
- **Critical minimum effort:** This is the minimum amount of investment needed to make stimulants stronger than shocks, breaking the cycle of poverty and allowing for sustained economic growth.
- **Growth agents:** These are the individuals and activities (like entrepreneurs, innovators, and savers) that are essential for generating the positive stimulants needed for growth.

How it works

- **Below the critical minimum:** If the investment is less than the critical minimum, any temporary increase in income is quickly wiped out by the overpowering "shocks" of poverty, and the economy falls back to its low-income equilibrium.
- **At the critical minimum:** Once the investment reaches the critical minimum level, the stimulants and shocks are balanced. This is the point where stimulants can begin to cause continuous growth and pull the economy toward a higher income level.

Criticisms of the theory

- **Unspecified amount:** The theory doesn't provide a precise value for the "critical minimum effort".
- **Ignores other factors:** It overlooks the importance of non-economic factors and the role of monetary and fiscal policy, international trade, and government intervention.
- **Practicality:** It doesn't explain how developing nations would actually secure the large sum of investment required.

UTILIZING SURPLUS MANPOWER (NURKSE'S THEORY)

For Leibenstein's theory to be successful, a large pool of resources for investment is required. This is where Ragnar Nurkse's theory on disguised unemployment provides a critical piece of the puzzle.

Nurkse defined disguised unemployment as a situation in rural, agricultural areas where more people are working than are necessary to produce the current output. Their marginal productivity is effectively zero or even negative, meaning they contribute little to nothing to total output.

Nurkse argued that this disguisedly unemployed labor represents a "disguised savings potential" or a hidden source of capital formation that can be tapped for development projects.

Here's how Nurkse's concept works:

1. **Release the labor:** Excess workers can be withdrawn from the agricultural sector without reducing the total agricultural output.
2. **Redirect the resources:** The food that these surplus workers would have consumed is now effectively a "surplus" in the agricultural sector. This surplus can be collected and used to feed the same workers who are now employed in capital-intensive projects.
3. **Mobilize for capital projects:** The mobilized workers can be used to build capital assets like roads, dams, bridges, and factories. With no opportunity cost for their labor (since their marginal product was zero), they can build up the nation's capital stock.
4. **Fund the critical minimum effort:** This freed-up labor can be viewed as an internal source of investment for the "critical minimum effort." The investment is made not through external borrowing, but by utilizing a country's most abundant resource: its excess labor.

Synthesis of the two theories

The utilization of surplus manpower is directly connected to the critical minimum effort theory as a potential funding mechanism:

1. **Generating the large investment:** Nurkse's model provides a pathway for a developing country to generate the large-scale investment required by Leibenstein's critical minimum effort theory from internal resources, rather than relying solely on foreign aid or high domestic savings, which are often scarce.

2. **Breaking the trap:** By mobilizing surplus labor and channeling it into capital formation, a country can achieve the "critical minimum effort." This initiates a virtuous cycle where increased productivity expands the market, creating higher real incomes and eventually causing population growth to decline.

Limitations and challenges

Implementing this strategy faces significant challenges that both theorists acknowledged:

1. **Practical difficulties:** Identifying and organizing disguisedly unemployed workers is logistically complex. The workers are typically unskilled, while many capital projects require skilled labor and modern equipment.

2. **Leakages in savings potential:** The food surplus created by moving workers could be consumed by those remaining in agriculture rather than being transferred to the capital projects.

3. **Administrative hurdles:** A successful mobilization of surplus labor requires robust administrative capacity, and the government must find a way to fund and manage the projects and transfer the agricultural surplus to the new industrial workforce.

LEWIS THEORY OF DEVELOPMENT

W. Arthur Lewis's theory of development, also known as the dual-sector model, describes the economic transition from a traditional agricultural economy to a modern industrial one by transferring surplus labor from the subsistence sector to a growing capitalist sector. The model assumes a dual economy with an unlimited supply of labor in agriculture, allowing the capitalist sector to expand by reinvesting profits and creating new jobs, a process that continues until the surplus labor is depleted.

Key components of the model

1. **Dual economy:**

The economy is divided into two sectors:

- **Subsistence sector:** A traditional agricultural sector with low productivity, often characterized by disguised unemployment, where workers have little incentive to stay due to low wages and surplus labor.
- **Capitalist sector:** A modern industrial sector driven by capital accumulation and using modern technology, which can absorb labor from the subsistence sector.

2. **Labor transfer:**

The modern sector attracts labor from the traditional sector by offering wages that are higher than subsistence wages but not necessarily based on marginal productivity.

3. **Capital accumulation and reinvestment:**

Capitalists in the modern sector generate profits because their revenue is higher than the wages paid. These profits are reinvested into the business, leading to capital accumulation, which in turn increases the capital stock and drives the expansion of the capitalist sector and the demand for labor.

4. **Lewis turning point:**

This process continues until the surplus labor in the agricultural sector is exhausted. At this point, the labor supply becomes elastic, and wages in the modern sector begin to rise, signaling that the economy is transitioning from a labor-surplus to a labor-scarce economy.

Assumptions and criticisms

Assumptions:

- An unlimited supply of labor in the agricultural sector.
- A fixed wage in the capitalist sector, determined by the subsistence wage plus a premium.
- Capitalists are profit-maximizers who save and reinvest their profits.

Criticisms:

- The assumption that profits are always reinvested is not always true; profits could be used for labor-saving technologies or lead to capital flight.
- The model can be inconsistent with historical evidence from developing countries where labor markets are not perfectly competitive and there is not an unlimited surplus of labor.

- It assumes a static wage in the modern sector, which may not be realistic as the labor surplus diminishes

RAGNAR NURKSE'S BALANCED GROWTH THEORY

The balanced growth theory is an economic theory pioneered by the economist Ragnar Nurkse (1907–1959). The theory hypothesises that the government of any underdeveloped country needs to make large investments in a number of industries simultaneously. This will enlarge the market size, increase productivity, and provide an incentive for the private sector to invest.

Nurkse was in favour of attaining balanced growth in both the industrial and agricultural sectors of the economy. He recognised that the expansion and inter-sectoral balance between agriculture and manufacturing is necessary so that each of these sectors provides a market for the products of the other and in turn, supplies the necessary raw materials for the development and growth of the other.

Nurkse and Paul Rosenstein-Rodan were the pioneers of balanced growth theory and much of how it is understood today dates back to their work.

Nurkse's theory discusses how the poor size of the market in underdeveloped countries perpetuates its underdeveloped state. Nurkse has also clarified the various determinants of the market size and puts primary focus on productivity. According to him, if the productivity levels rise in a less developed country, its market size will expand and thus it can eventually become a developed economy. Apart from this, Nurkse has been nicknamed an export pessimist, as he feels that the finances to make investments in underdeveloped countries must arise from their own domestic territory. No importance should be given to promoting exports.

Size of market and inducement to invest

The size of a market assumes primary importance in the study of what induces investment in a country. Ragnar Nurkse referenced the work of Allyn A. Young to assert that inducement to invest is limited by the size of the market. The original idea behind this was put

forward by Adam Smith, who stated that division of labour (as against inducement to invest) is limited by the extent of the market.

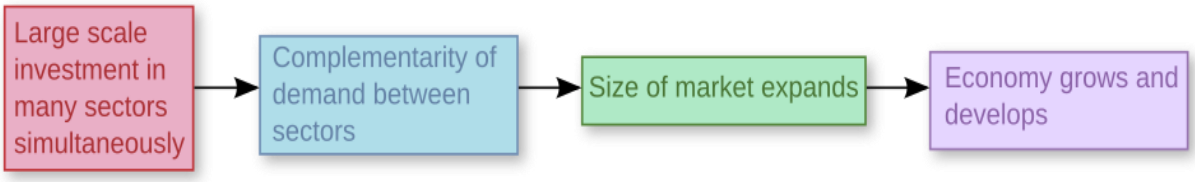
According to Nurkse, underdeveloped countries lack adequate purchasing power. *Low purchasing power* means that the real income of the people is low, although in monetary terms it may be high. If the money income were low, the problem could easily be overcome by expanding the money supply; however, since the meaning in this context is real income, expanding the supply of money will only generate inflationary pressure. Neither real output nor real investment will rise. A low purchasing power means that domestic demand for commodities is low. Apart from encompassing consumer goods and services, this includes the demand for capital as well.

The size of the market determines the incentive to invest irrespective of the nature of the economy. This is because entrepreneurs invariably take their production decisions by taking into consideration the demand for the concerned product. For example, if an automobile manufacturer is trying to decide which countries to set up plants in, he will naturally only invest in those countries where the demand is high. He would prefer to invest in a developed country, where though the population is lesser than in underdeveloped countries, the people are prosperous and there is a definite demand.

Private entrepreneurs sometimes resort to heavy advertising as a means of attracting buyers for their products. Although this may lead to a rise in demand for that entrepreneur's good or service, it does not actually raise the aggregate demand in the economy. The demand merely shifts from one provider to another. Clearly, this is not a long-term solution.

Ragnar Nurkse concluded,

"The limited size of the domestic market in a low income country can thus constitute an obstacle to the application of capital by any individual firm or industry working for the market. In this sense the small domestic market is an obstacle to development generally."

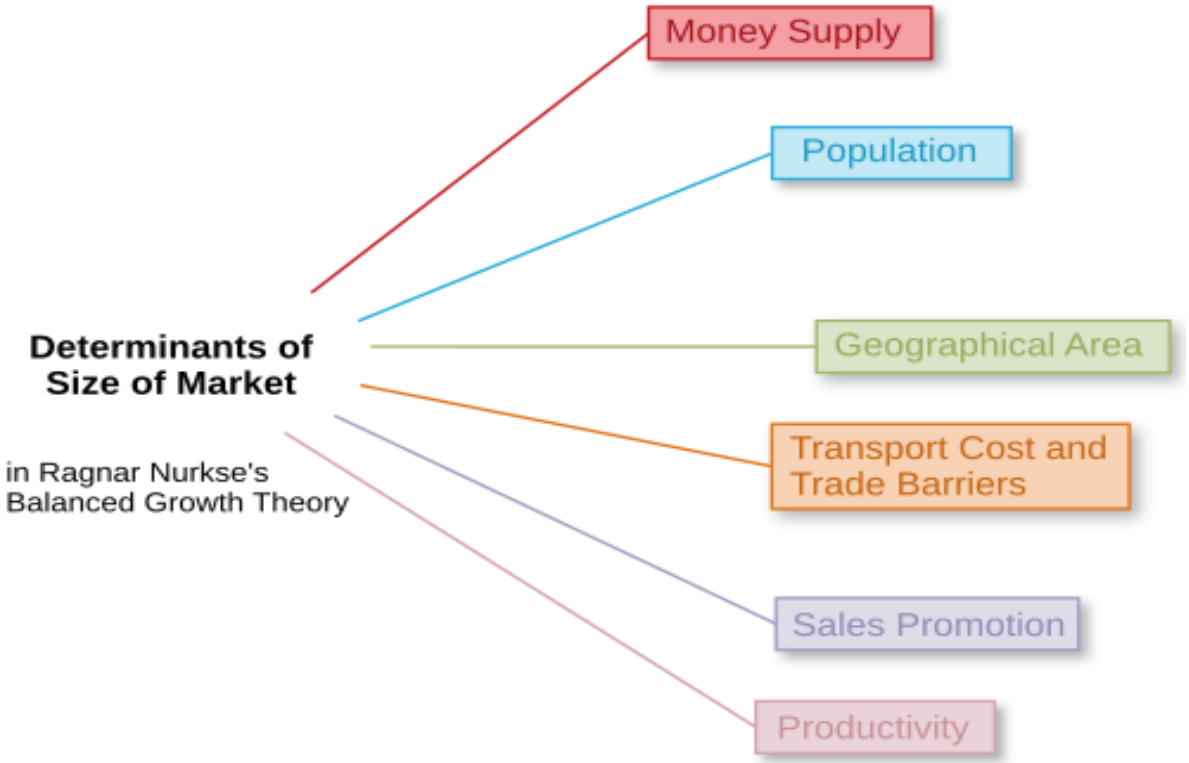


The process of economic development as per Ragnar Nurke's Balanced Growth Theory

The process of economic development as per Ragnar Nurkse's balanced growth theory

Determinants of size of market

According to Nurkse, expanding the size of the market is crucial to increasing the inducement to invest. Only then can the *VICIOUS CIRCLE OF POVERTY* be broken. He mentioned the following pertinent points about how the size of the market is determined:



Money supply

Nurkse emphasised that Keynesian theory shouldn't be applied to underdeveloped countries because they don't face a lack of effective demand in the way that developed countries do. Their problem is to do with a lack of real purchasing power due to low productivity

levels. Thus, merely increasing the supply of money will not expand the market but will in fact cause *inflationary pressure*.

Population

Nurkse argued against the notion that a large population implies a large market. Though underdeveloped countries have a large population, their levels of productivity are low. This results in low levels of per capita real income. Thus, consumption expenditure is low, and savings are either very low or completely absent. On the other hand, developed countries have smaller populations than underdeveloped countries but by virtue of high levels of productivity, their per capita real incomes are higher and thus they create a large market for goods and services.

Geographical area

Nurkse also refuted the claim that if a country's geographical area is large, the size of its market also ought to be large. A country may be extremely small in area but still have a large effective demand. For example, Japan. In contrast, a country may cover a huge geographical area but its market may still be small. This may occur if a large part of the country is uninhabitable, or if the country suffers from low productivity levels and thus has a low National Income.

Transport cost and trade barriers

The notion that transport costs and trade barriers hinder the expansion of the market is age-old. Nurkse emphasised that tariff duties, exchange controls, import quotas and other non-tariff barriers to trade are major obstacles to promoting international cooperation in exporting and importing. More specifically, due to high transport costs between nations, producers do not have an incentive to export their commodities. As a result, the amount of capital accumulation remains small. To address this problem, the United Nations produced a report in 1951 with solutions for underdeveloped countries. They suggested that they can expand their markets by forming customs unions with neighbouring countries. Also, they can adopt the system of preferential taxation or even abolish customs duties altogether. The logic was that once customs duties are removed, transport costs will fall. Consequently, prices will fall and thus the demand will rise. However, Nurkse, as an export pessimist, did not agree with this view. Export

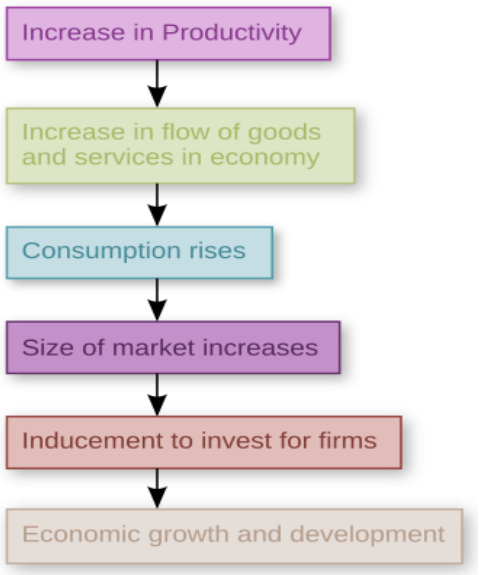
pessimism is a trade theory which is governed by the idea of "inward looking growth" as opposed to "outward looking growth". (See Import substitution industrialization)

Sales promotion

Often, it is true that a company's private endeavour to increase the demand for its products succeeds due to the extensive use of advertisement and other sales promotion technique. However, Nurkse argues that such activities cannot succeed at the macro level to increase a country's aggregate demand level. He calls this the *"macroeconomic paradox"*.

Productivity

Nurkse stressed productivity as the *primary determinant of the size of the market*. An increase in productivity (defined as the output per unit input) increases the flow of goods and services in the economy. As a response, consumption also rises. Hence, underdeveloped economies should aim to raise their productivity levels in all sectors of the economy, in particular agriculture and industry.



The process of how increased productivity leads to economic development and growth

For example, in most underdeveloped economies, the *technology* used to carry out agricultural activities is backward. There is a low degree of mechanisation coupled with rain dependence. So while a large proportion of the population (70–80%) may be actively employed in the agriculture

sector, the contribution to the Gross Domestic Product may be as low as 40%.[7] This points to the need to increase output per unit input and *output per head*. This can be done if the government provides irrigation facilities, high-yielding variety seeds, pesticides, fertilisers, tractors etc. The positive outcome of this is that farmers earn more income and have a higher purchasing power (real income). Their demand for other products in the economy will rise and this will provide industrialists an incentive to invest in that country. Thus, the size of the market expands and improves the condition of the underdeveloped country.

Nurkse is of the opinion that Say's law of markets operates in underdeveloped countries. Thus, if the money incomes of the people rise while the price level in the economy stays the same, the size of the market will still not expand till the real income and productivity levels rise. To quote Nurkse,

"In underdeveloped areas there is generally no 'deflationary gap' through excessive savings. Production creates its own demand, and the size of the market depends on the volume of production. In the last analysis, the market can be enlarged only through all-round increase in productivity. Capacity to buy means capacity to produce."

Export pessimism

Citing the limited size of the market as the main impediment in economic growth, Nurkse reasons that an increase in productivity can create a virtuous circle of growth. Thus, a large scale investment programme in a wide array of industries simultaneously is the answer. The increase in demand for one industry will lead to an increase in demand for another industry due to *complementarity of demands*. As Say's law states, *supply creates its own demand*.

However, Nurkse clarified that the finance for this development must arise to as large an extent as possible from the underdeveloped country itself i.e. domestically. He stated that financing through increased trade or foreign investments was a strategy used in the past – the 19th century – and its success was limited to the case of the United States of America. In reality, the so-called "new countries" of the United States of America (which separated from the British empire) were high income countries to begin with. They were already endowed with efficient producers, effective markets and a high purchasing power. The point Nurkse was trying to make was that USA was rich in resource endowment as well as labour force. The labour force had merely

migrated from Britain to USA, and thus their level of skills were advanced to begin with. This situation of outward led growth was therefore unique and not replicable by underdeveloped countries.

In fact, if such a strategy of financing development from outside the home country is undertaken, it creates a number of problems. For example, the foreign investors may carelessly misuse the resources of the underdeveloped country. This would in turn limit that economy's ability to diversify, especially if natural resources were plundered. This may also create a distorted social structure. Apart from this, there is also a risk that the foreign investments may be used to finance private luxury consumption. People would try to imitate Western consumption habits and thus a balance of payments crisis may develop, along with economic inequality within the population.

Another reason exports cannot be promoted is because in all likelihood, an underdeveloped country may only be skilled enough to promote the export of primary goods, say agricultural goods. However, since such commodities face inelastic demand, the extent to which they will sell in the market is limited. Although when population is at a rise, additional demand for exports may be created, Nurkse implicitly assumed that developed countries are operating at the replacement rate of population growth. For Nurkse, then, exports as a means of economic development are completely ruled out.

Thus, for a large-scale development to be feasible, the requisite capital must be generated from within the country itself, and not through export surplus or foreign investment.[6] Only then can productivity increase and lead to increasing returns to scale and eventually create virtuous circles of growth.

Role of state

After World War II, a debate about whether a country should introduce *financial planning* to develop itself or rely on *private entrepreneurs* emerged. Nurkse believed that the subject of who *should* promote development does not concern economists. It is an administrative problem. The crucial idea was that a large amount of well dispersed investment should be made in the economy, so that the market size expands and leads to higher productivity levels, increasing returns to scale and eventually the development of the country in question. However, most economists who favoured the balanced growth hypothesis believed that only the state has

the capacity to take on the kind of heavy investments the theory propagates. Further, the gestation period of such lumpy investments is usually long and private sector entrepreneurs do not normally undertake such high risks.

RURAL URBAN MIGRATION IN INDIA

Rural-urban migration in India is primarily driven by the search for better livelihood, higher wages, and improved education and healthcare in urban areas, while rural areas often suffer from economic disparities, poor infrastructure, and limited job opportunities. Although rural-to-rural migration is the dominant form of movement, there's a consistent flow from rural to urban areas due to imbalances in development. This migration leads to significant urban growth but also creates challenges such as income disparities, poor living conditions in urban slums, and difficulty in social integration for migrants.

Key Drivers of Migration

- **Economic Opportunities:** Migrants move to cities for better-paying jobs and more stable employment, especially in the industrial and service sectors.
- **Improved Living Standards:** Urban areas are perceived to offer better living conditions, access to education, and quality healthcare, which are often lacking in rural areas.
- **Rural Disparities:** Regional economic imbalances and the lack of growth in agricultural productivity push people to seek opportunities elsewhere.

Migration Trends and Statistics

- **Dominance of Rural-to-Rural Migration:** While rural-to-urban migration is significant, it is not the primary form of migration; a majority of migrants in India move from one rural area to another.
- **Male vs. Female Migration:** Male migrants are more likely to move from rural to urban areas in search of employment, while female migration is often for marriage, though rural-to-urban movement for work is also substantial for women.

- **Growing Urban Population:** India's urban population is growing rapidly, with predictions of reaching 600 million by 2030, suggesting continued migration.

Challenges for Migrants

- ❖ **Informal Sector Jobs:** Many migrants find themselves in low-skilled, informal sector jobs with limited job security and inadequate wages.
- ❖ **Poor Living Conditions:** Migrants often end up in marginal settlements, slums, and overcrowded areas with poor access to basic amenities and services.
- ❖ **Social and Cultural Barriers:** Difficulty integrating into urban societies, language barriers, and discrimination can hinder migrants' well-being.
- ❖ **Lack of Access to Services:** Migrants face barriers in accessing quality education and healthcare for their families, perpetuating cycles of poverty.

Opportunities and Solutions

- ✓ **Slum Upgrading Programs:** Initiatives to improve existing slums with basic infrastructure and land tenure can help residents.
- ✓ **Urban Entrepreneurship:** Support for migrant entrepreneurship through training and seed funding can create economic independence.
- ✓ **Policy Interventions:** Implementing effective labor laws, ensuring equal wages, and promoting sustainable urban development are crucial for managing migration.

HARRIS-TODARO MODEL

The Harris-Todaro model is an economic theory that explains rural-urban migration, particularly in developing countries, by focusing on the decision-making process of individuals. It posits that migration is driven by a comparison of expected urban income versus actual rural income, not just the difference in actual earnings. People are more likely to move to cities if they expect the urban wage, multiplied by the probability of finding a job, to be higher than their current rural wage. This often leads to urban unemployment as the formal sector cannot absorb

all the new arrivals, and many end up in a lower-paying informal sector.

Key components of the model

- **Expected vs. Actual Income**: The model is based on the idea that migrants make a rational decision based on the expected future income in the urban sector, not just the current difference in wages.
- **Probability of Employment**: The expected urban income is calculated by multiplying the actual urban wage by the probability of finding a job in the formal sector. For example, if the urban wage is 60 and there is a 40% chance of getting a job, the expected wage is 24 (60×0.4).
- **Migration Decision**: Individuals will migrate if their expected urban income is greater than their actual rural income.
- **Urban Labor Market Structure**: The model includes both a formal sector with higher, inflexible wages (due to minimum wage laws or unions) and an informal sector where wages are lower. The formal sector's high wages attract migrants, but since not everyone gets a job, many are forced to take work in the informal sector.
- **Equilibrium**: An equilibrium is reached when the actual rural wage equals the expected urban wage.

Implications and policy

- ✓ **Urban Unemployment**: The model predicts that high urban wages can lead to high levels of urban unemployment, as more people are drawn to the city than can be absorbed by the formal sector.
- ✓ **Informal Sector**: The informal sector arises as a consequence of high formal wages and a surplus of labor, often characterized by lower wages and worker exploitation.
- ✓ **Policy Solutions**: To reduce migration and unemployment, policies might include restricting migration, or stimulating the formal sector through wage subsidies to firms, thereby creating more jobs at the higher wage level.

UNIT – III

HARROD DOMAR MODEL

The Harrod-Domar model explains economic growth by focusing on the relationship between an economy's savings rate and the productivity of capital (capital-output ratio). The core idea is that higher savings provide more funds for investment, which increases the capital stock and, consequently, drives higher economic growth. The model's key formula, G = S/v (ignoring depreciation), shows the growth rate (G) is directly proportional to the savings rate (S) and inversely proportional to the capital-output ratio (v), meaning lower capital-output ratios (more efficient capital) also lead to faster growth.

Key Assumptions

1. **Savings Equal Investment:** All savings are invested in the economy.
2. **Fixed Capital-Output Ratio:** The ratio of capital to output (v) is constant and does not change over time.
3. **Linear Production Function:** Output is directly proportional to the capital stock.
4. **Full Employment:** Resources, particularly labor and capital, are fully utilized.
5. **Closed Economy:** The model ignores international trade and capital flows.

Key Formula

The model uses the following formula to determine the economic growth rate (G):

$G = S / v$

Where:

- **G**: is the rate of economic growth (change in income).
- **S**: is the savings rate (the proportion of income saved).
- **v**: is the capital-output ratio (the amount of capital required to produce one unit of output).

Implications

1. **Higher Savings = Faster Growth:** An increase in the savings rate leads to a higher growth rate, as there is more capital available for investment.
2. **More Efficient Capital = Faster Growth:** A decrease in the capital-output ratio (meaning capital is used more efficiently) also leads to a higher growth rate.

Limitations

1. **Unrealistic Assumptions:** The model relies on rigid assumptions, such as a fixed capital-output ratio and a constant production function, which may not hold true in the real world.
2. **Ignores Labor:** The model primarily focuses on capital accumulation and does not adequately account for the role of labor in economic growth.
3. **No Natural Growth Rate:** The model provides no mechanism for achieving balanced or sustained growth, often suggesting an unstable economy.

CRITICAL EXPANSION AND RATIONALE

The Harrod-Domar model is a Keynesian economic growth model that argues growth is driven by savings and investment, with a higher savings rate leading to faster growth. Its main rationale is that investment adds to the capital stock, which increases the economy's productive capacity, and for stable growth, this new capacity must be matched by a corresponding increase in demand. A critical point is the model's instability, suggesting that if the growth rate is disturbed, cumulative forces will push the economy further into either inflation or recession because of its assumptions, such as fixed factor proportions.

Critical expansion

- **Rate of growth (Gw):** The model suggests the warranted rate of growth, which is the rate at which the economy can achieve steady growth, is determined by the savings rate (s) and the capital-output ratio (Cr).

- **Formula**:

  The relationship is expressed as $Gw=s/Cr$.

- **Interpretation**:

  A higher savings rate (s) leads to faster growth, while a lower capital-output ratio (Cr) (meaning investment is more productive) also leads to faster growth.

- **Example**:

  If the savings rate is 10% and the capital-output ratio is 2, the growth rate is 5% (0.10/2=0.05). If the savings rate increases to 20% and the capital-output ratio falls to 1.5, the growth rate jumps to 13.3% (0.20/1.5≈0.133).

Rationale and core principles

1. **Role of savings and investment**: The model is built on the principle that savings are the source of funds for investment. Investment increases the capital stock, which in turn boosts the economy's output.
2. **Capital as the driver**: The model posits that capital accumulation is the primary engine of long-run economic growth. A higher savings rate directly translates to higher investment and faster capital accumulation.
3. **Capital-output ratio**: The efficiency of capital is crucial. A lower capital-output ratio indicates that less capital is needed to produce a unit of output, making investment more efficient and leading to higher growth rates.
4. **Balanced growth**: For growth to be steady, new investment must not only increase productive capacity but also generate enough demand to absorb the new output. If demand doesn't keep pace with supply, it can lead to unemployment or inflation.

Critical assumption and implications

1. **Instability**: A major criticism is that the model is highly unstable. It suggests that any deviation from the steady-growth path is likely to be amplified by the economy's own forces, leading to either a recession or inflation.
2. **Fixed proportions**: This instability is largely a result of the assumption of fixed factor proportions, meaning capital and labor cannot be substituted for one another. In reality, substitutions are possible, and the relationship between capital and labor is more flexible.
3. **Application to developing economies**: The model is often considered more applicable to developing countries where capital is a more significant limiting factor for growth than labor.

SOLOW MODEL OF GROWTH

The Solow growth model is an economic model that explains long-term economic growth by focusing on capital accumulation, labor force growth, and technological progress. It shows that while saving and investment increase capital stock, diminishing returns mean growth slows without technological advancements. The model posits that only technological progress can sustain long-run economic growth by increasing the productivity of labor and capital.

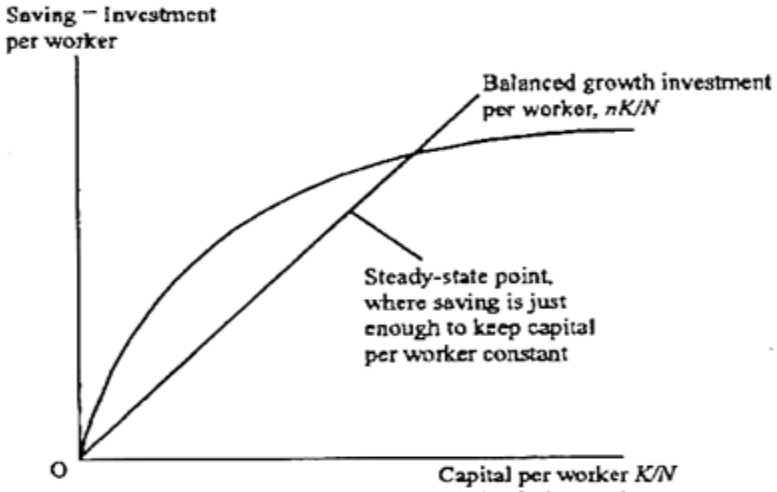


Fig. 6 : The Solow Model of Growth

Key components and assumptions

- **Production Function:** Output (Y) is a function of capital (K) and labor (L), and technology (A). A common form is $Y=F(K,L)=AKaL(1-a)$.

- **Capital Accumulation:** The change in the capital stock depends on investment (a fraction s of output is saved and invested) and depreciation (a constant fraction d of capital wears out). The capital accumulation equation is $K'=K(1-d)+sY$..
- **Labor Force:** The labor force grows at a constant rate, n.
- **Technological Progress:** Technology improves at a constant rate, g, increasing the productivity of both capital and labor.

How it works

- **Diminishing Returns:** As capital per worker increases, each additional unit of capital yields a smaller increase in output.
- **Steady State:** The economy eventually reaches a "steady state," where the amount of capital per worker is constant. This occurs when investment is just enough to replace depreciated capital and equip new workers, so net investment is zero.
- **Long-run growth:** At the steady state, output per worker stops growing. The only way to achieve sustained long-run growth in output per worker is through technological progress (g).
- **Convergence:** Without differences in technology, economies with the same savings rate, population growth rate, and depreciation rate will converge to the same steady-state level of capital per worker.

Implications

- Changes to the savings rate, population growth rate, or depreciation rate affect the level of output per worker but not its long-term growth rate.
- Technological progress is the sole driver of sustained long-run growth in output per worker.
- Investment in human capital is crucial because it complements physical capital, improves labor productivity, and leads to higher economic outputs.

TECHNICAL PROGRESS AND GROWTH

In the Solow growth model, technical progress is the sole driver of sustained per capita income growth in the long run. While capital accumulation drives growth in the short to medium term, the model shows that this is constrained by diminishing returns and eventually leads to a "steady state" where capital per worker is constant. Technical progress is seen as an exogenous factor that boosts the productivity of both capital and labor, allowing for continuous increases in output per worker beyond what is possible through capital alone.

Role of technical progress

1. **Solves the long-run growth problem:** The model concludes that with diminishing returns to capital, economies cannot grow indefinitely from capital accumulation alone. Technological progress is necessary to overcome this limitation and achieve continuous long-term growth in per capita income.
2. **Exogenous to the model:** In the basic Solow model, technological progress is assumed to occur at a constant, external rate, not as a result of other economic variables like savings or investment. This is sometimes referred to as "exogenous" technical progress.
3. **Augments labor and capital:** Technical progress increases the productivity of both labor and capital, meaning that each worker can produce more output given the same amount of capital. This is often represented by a term in the production function that increases over time.
4. **Drives long-run convergence:** The model suggests that poorer countries will grow faster than richer countries because they have lower initial capital per worker. However, it is technological progress, and not just capital accumulation, that allows them to "catch up" in the long run.

Technical progress vs. other factors

1. **Level effects:** Increases in the savings rate or decreases in the population growth rate can lead to a higher level of output per worker in the long run, but they do not affect the long-run growth rate of per capita income.
2. **Rate effects:** Only an increase in the rate of technical progress can lead to a sustained and higher rate of growth of output per capita over time.

HUMAN CAPITAL AND GROWTH

The Solow model can be expanded to include human capital, which increases the productivity of labor, by modifying the production function to include a human capital term (ht) alongside physical capital (Kt) and labor (Lt). This addition allows the model to better explain variations in growth rates between countries, as education and skills raise output per person just as technology does. This "human capital augmented Solow model" can then analyze how human capital accumulation, alongside savings rates and technological progress, affects long-run economic growth.

How human capital is integrated

1. **Augmented production function**: The standard Solow production function, $Y=F(K,L)$, is modified. A common way is to add human capital (ht) as a factor that increases labor's productivity, resulting in an equation like $Yt=K\alpha t(AthtLt)1-\alpha$
2. **Human capital as a productivity enhancer**: Human capital, representing skills, experience, and education, acts like technology to raise the productivity of labor.
3. **New growth equation**: The model's equations of motion are extended to include a second equation for how human capital per worker accumulates over time, driven by savings in human capital and offset by depreciation and "inefficiency".

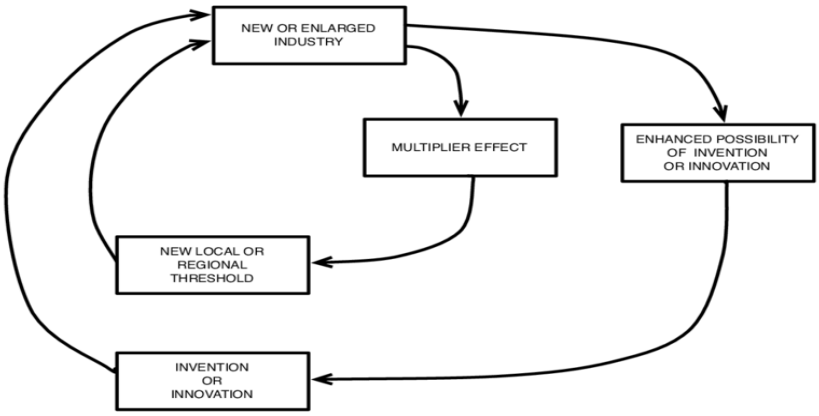
Implications for growth

1. **Explains cross-country differences**: By including human capital, the model can better explain why some economies grow faster than others. Differences in educational attainment and investment in human capital can lead to different steady states of output per capita.
2. **Enhances the role of investment**: Investments are now needed not only for physical capital but also for human capital (e.g., education, training). The model can then analyze the impact of investment ratios in both physical and human capital on growth.

3. **Convergence**: The augmented model supports the concept of "conditional convergence," where countries with similar savings rates and human capital growth rates will converge to the same steady state, regardless of their initial income level.

MYRDAL MODEL

The Myrdal model, also known as the theory of cumulative causation, explains how economic development and regional inequalities can perpetuate themselves through self-reinforcing cycles. The model posits that a prosperous region's growth can create both "spread effects," which help nearby regions, and "backwash effects," which pull resources away from them. The balance between these forces determines whether regions grow together or diverge, with backwash effects often dominating to increase inequality, which Myrdal argued requires government intervention to correct.

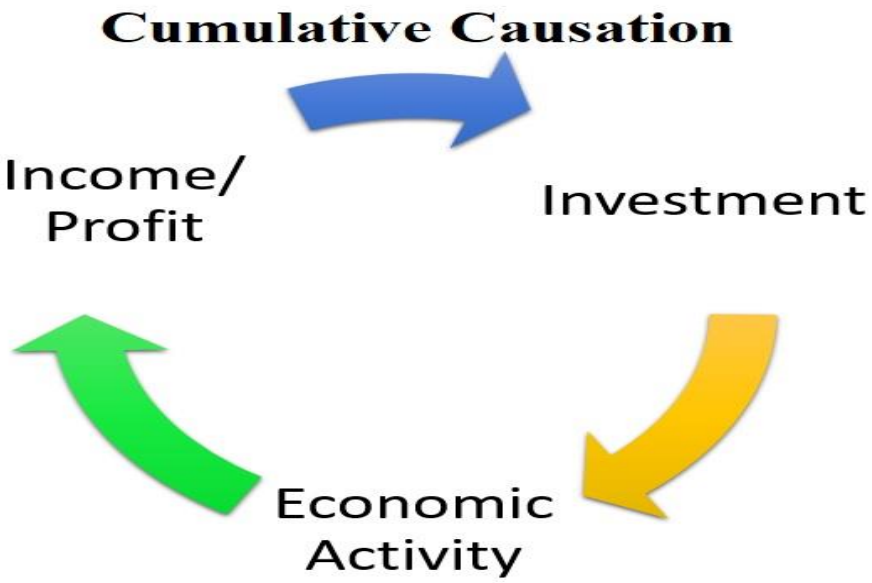


Key concepts of the Myrdal model

1. **Circular and cumulative causation:** This core concept suggests that a change in one area creates a series of linked and self-reinforcing changes that lead to further development.
2. **Spread effects:** These are the positive forces that stimulate growth in other regions. They include increased demand for goods from peripheral areas and the spread of new technologies and capital from the core region.

3. **Backwash effects:** These are the negative forces that hinder growth in poorer regions. They include the migration of skilled labor and capital from the periphery to the core, which drains resources from the poorer areas.
4. **Interdependence:** The model emphasizes the interplay of economic and non-economic factors, such as social cohesion and confidence, in shaping development.
5. **Government intervention:** Myrdal believed that government intervention is necessary to mitigate the negative "backwash effects" and promote more balanced, equitable regional growth.

MYRDAL'S MODEL OF CUMULATIVE CAUSATION THESIS



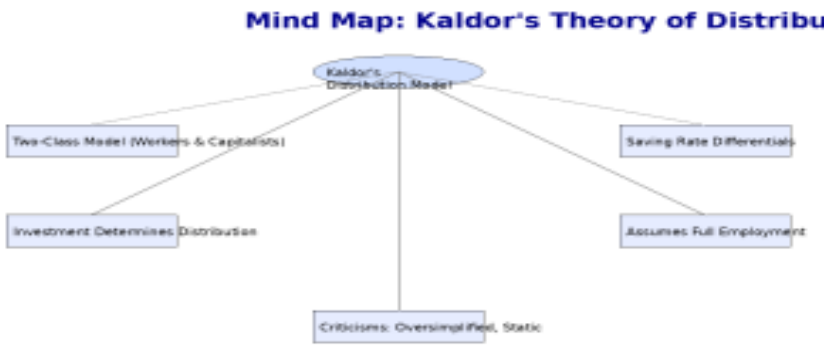
Myrdal's model of cumulative causation hypothesizes that economic development in one region can trigger a cycle of both "spread effects" (positive) and "backwash effects" (negative) in other regions. The thesis is that market forces often lead to increasing regional inequality, as "backwash effects" like out-migration of capital and labor from poorer regions can cause those areas to fall further behind. This creates a self-reinforcing loop where affluent regions get richer while poor regions get poorer, a cycle that can only be broken by government intervention to promote balanced growth.

Core components of the thesis

1. **Circular and cumulative causation:** Economic activities and development are linked in a circular and cumulative way.
2. **Spread effects:** These are the positive impacts from a growing region on its periphery, such as increased demand for goods and services, which can stimulate local growth.
3. **Backwash effects:** These are the negative impacts, such as when the growth of a core region leads to the loss of human capital (out-migration) and resources from peripheral regions.
4. **Divergence over convergence:** The model suggests that market forces, left unchecked, will lead to divergence rather than convergence between regions.
5. **Role of government intervention:** Myrdal believed that government intervention is necessary to counteract the negative backwash effects and ensure that the spread effects are strong enough to create a virtuous cycle of growth in lagging regions.
6. **"Poverty perpetuates poverty":** This is a key tenet, where a lack of investment and opportunity in a poor region can create a downward spiral that is difficult to escape without external help.
7. **"Affluence promotes affluence":** Conversely, wealthy regions can experience a positive feedback loop, as initial success attracts more investment and activity, leading to further growth.

KALDOR MODEL OF DISTRIBUTION

The Kaldor model of distribution is a post-Keynesian macroeconomic theory developed by Nicholas Kaldor that links income distribution to economic growth and investment. It is based on the assumption that capitalists have a higher marginal propensity to save than workers, so a higher profit share in national income leads to higher total savings and investment, thus driving economic growth. The model also assumes full employment and that investment is a primary driver of economic growth, creating a cyclical relationship where higher investment leads to higher growth and a shift in income distribution.



Key assumptions and concepts

1. **Different savings propensities**: A fundamental assumption is that the marginal propensity to save out of profits (sp) is greater than the marginal propensity to save out of wages (sw), i.e., $sp>sw$.
2. **Savings-investment equality**: For an economy to be in equilibrium, total savings must equal total investment ($S=I$).
3. **Savings function**: Total savings are a function of the distribution of income: $S=sp\cdot P+sw\cdot W$, where P is profits and $W$is wages.
4. **Profit-led growth**: Because capitalists save more, a larger share of national income going to profits leads to higher aggregate savings and, consequently, higher investment and economic growth.
5. **Full employment**: The model assumes the economy operates at full employment, which simplifies the analysis by removing the link between unemployment and income levels.
6. **Exogenous technological progress**: Technological advancements are considered to be an external factor that can influence the growth rate and the distribution of income.

Core idea

Kaldor's model argues that the share of profits in national income is determined by the ratio of investment to income (I/Y), specifically the ratio of investment to total income. A higher investment-to-income ratio leads to a larger profit share, as investment drives economic expansion. Conversely, a more equal distribution of income could foster greater consumption, which in turn promotes economic activity and potentially growth.

UNIT – IV

DEVELOPMENT PLANNING

Development planning is the strategic process of setting goals and outlining a plan to achieve them, applicable to individuals, organizations, or communities. It involves analyzing the current situation, prioritizing issues, setting objectives, and developing a roadmap with specific actions, resources, and timelines to foster improvement and growth, whether in professional skills or infrastructure.

For individuals

1. **Define goals:** Set clear career and personal goals.
2. **Assess current skills:** Evaluate strengths and areas for improvement.
3. **Create a plan:** Outline specific, measurable steps, strategies, and a timeline to achieve the goals.
4. **Evaluate progress:** Regularly review performance and adjust the plan as needed.
5. **Involves collaboration:** Often a joint effort between an employee and their manager.

For organizations and communities

1. **Analyze the situation:** Assess current conditions, needs, and opportunities.
2. **Set objectives:** Prioritize key issues and establish measurable goals.
3. **Develop a vision and plan:** Create a spatial or strategic vision, including projects, budgets, and policies to guide future growth.
4. **Allocate resources:** Plan for the best use of resources like land, money, and time.
5. **Ensure sustainability:** Incorporate economic, social, and environmental aspects for long-term, sustainable growth.
6. **Monitor and evaluate:** Establish criteria to evaluate whether goals are being met.

CONCEPTS AND RATIONALE

Development planning involves creating a strategic roadmap for achieving specific goals by analyzing the current state, setting objectives, and outlining a process for resource allocation and implementation over a set time frame. The rationale is to achieve organized growth and progress, whether at a national, organizational, or individual level, by systematically directing efforts toward desired outcomes and overcoming market failures, skill gaps, or underdevelopment. This process helps in everything from improving an employee's skills to developing a nation's infrastructure.

Key concepts

1. **Goal-oriented:** Plans are built around specific, pre-determined social, economic, and political objectives, which must be clearly defined and have a timeframe.
2. **Resource management:** A core function is the conscious and organized allocation of scarce resources (financial, human, etc.) to achieve the objectives efficiently.
3. **Strategic process:** It involves a continuous effort that includes analyzing the current situation, prioritizing issues, setting goals, and developing specific strategies, projects, and budgets.

4. **Holistic perspective:** Development planning can encompass a broad range of areas, including economic, social, environmental, and technological factors, to ensure comprehensive and sustainable growth.
5. **Implementation and oversight:** A plan requires a system for implementation, monitoring, and evaluation, which may involve multiple levels of government, different agencies, or a manager-employee relationship.

Rationale

1. **Overcoming market limitations:** In economies, development planning is often used to correct market failures and ensure that resources are directed toward public goods like infrastructure and social programs, which the market may not provide sufficiently.
2. **Breaking poverty cycles:** For less-developed countries, planned development is a strategy to break a cycle of low savings and low income by boosting aggregate demand and supply through public spending on projects.
3. **Improving performance:** At the organizational level, development planning helps employees improve their current job skills and prepare for future roles, which increases overall business performance and productivity.
4. **Ensuring sustainable growth:** By incorporating economic, social, and environmental aspects, development planning ensures that growth is not just short-term but sustainable and beneficial to the community or organization in the long run.
5. **Aligning individual and organizational goals:** It provides a framework for employees to set personal career goals while ensuring those goals align with the needs and objectives of the organization, leading to increased employee satisfaction and retention.

BASIC MODELS OF DEVELOPMENT PLANNING PROCESS

Basic development planning models include aggregate growth models for overall economic changes, sectoral models to analyze specific industries, and inter-industry models (like input-output) to understand relationships between sectors. Other common models are the linear (sequential) and iterative

(cyclical) approaches, as well as the participatory model, which prioritizes community involvement in planning.

Models of development planning

1. **Aggregate Growth Models:** These models focus on macroeconomic estimates, like changes in national income, savings, and investment, to forecast overall economic growth.
2. **Sectoral Models:** These models examine the structural relationships within major sectors of an economy, such as agriculture, manufacturing, and services, and how they relate to each other.
3. **Inter-industry Models:** Also known as input-output models, these analyze the flow of goods and services between different producing sectors of an economy to understand their interdependencies.
4. **Linear Model:** This is a sequential, step-by-step approach that moves from one phase to the next: identify needs, set objectives, design interventions, implement, and then evaluate outcomes.
5. **Iterative Model:** This model is cyclical and allows for continuous improvement. It uses feedback loops where the results of one phase are used to inform and refine the next.
6. **Participatory Model:** This model emphasizes involving stakeholders and community members in the planning process to ensure the plan reflects their needs and priorities.
7. **Strategic Planning Model:** This is a long-term, goal-oriented model that involves envisioning a future state and creating a roadmap, often using tools like SWOT analysis.

GOVERNMENT FAILURE AND MARKET ECONOMY

Government failure in a market economy occurs when government intervention, intended to fix a market problem, creates its own inefficiencies or makes the original problem worse. This happens when the costs of an intervention outweigh the benefits, leading to a misallocation of resources and reduced social welfare. Examples include rent control leading to a housing shortage or agricultural subsidies causing overproduction.

How it differs from market failure

1. **Market failure**: The free market, on its own, fails to allocate resources efficiently due to issues like monopolies, externalities, or information asymmetry.

2. **Government failure**: Occurs when government action to correct market failure results in a worse outcome than the market would have produced on its own.

Causes of government failure

1. **Information problems**: Governments may not have complete information to make the best policy decisions.
2. **Bureaucracy and administrative costs**: The costs of implementing and maintaining a government program can be too high.
3. **Political motivation**: Government actions may be driven by political interests rather than economic efficiency.
4. **Unintended consequences**: Interventions can have unforeseen negative effects, such as rent control leading to reduced housing supply and poor property maintenance.
5. **Vested interests**: Powerful groups may influence policy in their favor, even if it's not in the public interest.

Examples

1. **Rent control**: Meant to make housing more affordable, it can lead to a decrease in housing supply, neglect of existing properties, and black markets for housing.
2. **Agricultural subsidies**: Can encourage overproduction of certain crops, leading to wasted resources and lower prices for farmers in the long run.
3. **Excessive regulation**: Can stifle innovation and competition, making markets less efficient.

Conclusion

Government failure highlights that government intervention is not always the solution to market problems. It underscores the importance of carefully weighing the potential costs and benefits before intervening in a market economy. The core question is not whether markets are

perfect, but whether government intervention or the free market is the better system for a given problem.

ROLE OF NGOs IN ECONOMIC DEVELOPMENT

NGOs contribute to economic development by delivering essential services, empowering communities through skill development and microfinance, and advocating for policy changes to create a more inclusive economy. They act as a bridge between governments and citizens, support entrepreneurs, help implement government programs, and provide humanitarian aid during crises, addressing gaps in government services and fostering overall social and economic progress.

Key roles of NGOs in economic development

1. **Service delivery**: Many NGOs provide critical services like healthcare and education, especially in areas where government services are lacking. They also implement programs for poverty alleviation, rural development, and sanitation.
2. **Community empowerment and skill development**: NGOs empower local communities by providing them with skills, knowledge, and resources. This includes vocational training in fields like IT and agriculture, helping people find employment and improve their livelihoods.
3. **Financial inclusion and entrepreneurship**: Through microfinance, NGOs provide small loans to entrepreneurs and women, helping them start or expand businesses. They also offer mentorship and support to small-scale businesses.

4. **Advocacy and policy influence**: NGOs advocate for social and economic justice by pushing for policy reforms and influencing government decisions on issues such as women's rights, fair wages, and environmental protection. They have been instrumental in the creation of government schemes and laws.
5. **Bridging the government-citizen gap**: NGOs act as intermediaries, ensuring that development programs reach the intended beneficiaries. They facilitate dialogue and ensure accountability, helping government programs to be implemented effectively on the ground.
6. **Humanitarian assistance**: In times of disaster or crisis, NGOs provide immediate relief like food, water, and shelter. This role is crucial for maintaining social stability and meeting immediate needs in affected areas.
7. **Research and awareness**: Many NGOs conduct research on important issues, generate data, and raise public awareness, which informs policy decisions and public discourse.
8. **Promoting sustainable development**: NGOs work on environmental conservation and promoting sustainable practices, advocating for the responsible use of natural resources and raising awareness about issues like climate change.

TRENDS IN GOVERNANCE AND REFORMS

Key trends in governance and reforms include digital transformation, the integration of AI and data, and a growing emphasis on sustainability and ESG principles. Governments are modernizing to improve efficiency, transparency, and citizen engagement through initiatives like e-governance, while also addressing issues such as climate change and public trust. Corporate governance is also evolving, focusing on technology, board diversity, stakeholder engagement, and greater accountability.

Trends in public governance

1. **Digitalization and e-governance:** Governments are using technology to make services more accessible and efficient, as seen in initiatives like India's 'Digital India' program.

2. **AI and data:** The use of Artificial Intelligence and data analytics is increasing to guide policy and improve public service delivery, though ethical considerations and workforce training are critical for successful implementation.
3. **Sustainability and climate change:** There is a growing focus on implementing climate-friendly policies and promoting sustainable development.
4. **Public service modernization:** Reforms are focused on making public services more modern, citizen-centric, and responsive to the needs of the public.
5. **Citizen engagement:** Governments are trying to increase citizen participation and build trust through greater transparency and inclusive policy-making processes, especially for marginalized groups.

Trends in corporate governance

1. **ESG integration:** There is a greater emphasis on Environmental, Social, and Governance (ESG) factors as a key component of a company's strategy and performance.
2. **Board diversity and skills:** Companies are working to create more diverse and skilled boards to better navigate complex challenges.
3. **Technology adoption:** The use of technology is seen as crucial for creating more scalable and efficient governance frameworks.
4. **Stakeholder engagement:** Corporations are increasing their engagement with a wider range of stakeholders beyond shareholders to ensure long-term value creation.

Reforms and objectives

1. **Improved efficiency:** Reforms aim to reduce bureaucracy and streamline operations to achieve lower costs and higher value in public services.
2. **Enhanced accountability and transparency:** A major goal is to increase transparency, reduce corruption, and improve the accountability of both public and private institutions.
3. **Economic and social development:** Governance reforms are implemented to limit economic distortions, spur growth, and promote greater social inclusion.

4. **Building public trust:** With declining public trust in institutions, a significant reform objective is to rebuild faith in government and political organizations.

UNIT – V

ROLE OF FINANCIAL SYSTEM IN ECONOMIC DEVELOPMENT

The financial system is the backbone of economic development, channeling savings into productive investments to drive growth, innovation, and stability. Without a well-functioning financial system, economies cannot effectively allocate resources to their most productive uses.

Key roles of the financial system in economic development

1. **Mobilization of savings:** The financial system encourages people to save by offering various financial products like savings accounts and investment funds. Financial institutions then pool these savings, converting them into capital for investment. This process is critical for capital formation, which is essential for long-term economic expansion.

2. **Efficient allocation of resources:** The financial system directs capital to the most promising and productive investment projects. Through financial intermediaries like banks and stock markets, funds are moved from savers (who have a surplus) to borrowers (who have a need for capital). This efficient allocation supports businesses, infrastructure, and innovation, all of which accelerate economic growth.

3. **Provision of liquidity:** A liquid financial system allows investors to easily convert their assets into cash, providing flexibility and reducing the risk associated with illiquid investments. The ability to buy and sell securities quickly in markets like stock exchanges ensures that capital is never locked up, which promotes continuous investment and economic activity.

4. **Risk management:** The financial system provides tools for managing risk, which encourages a broader spectrum of investors and entrepreneurs to participate in economic activities. This includes offering various financial instruments, such as insurance, derivatives, and diversified investment options, which help individuals and businesses protect themselves from financial shocks.

5. **Facilitation of payments:** The financial system enables smooth and secure transactions through efficient payment and settlement systems. This infrastructure supports all economic activities, from daily purchases to large-scale business operations.

6. **Implementation of monetary policy:** Central banks use the financial system to control the money supply and influence interest rates. By managing liquidity and setting policy, central banks can promote stability, control inflation, and guide the economy toward sustained growth.

7. **Promotion of financial inclusion:** By expanding access to financial services to underserved populations, the financial system promotes inclusive economic growth. Microfinance institutions and digital banking platforms, for example, enable a wider range of people to save, invest, and access credit, which can help reduce poverty.

8. **Encouragement of entrepreneurial talent:** Financial institutions provide capital and consultancy services to entrepreneurs, supporting their risk-taking and innovative ventures. This support is vital for creating new businesses and fostering job growth.

9. **Balanced regional development:** The financial system helps promote more uniform development across a country by directing funds and resources toward less-developed or backward areas. This can be achieved through policies and incentives offered by financial institutions to support businesses in those regions.

FORMAL VERSUS INFORMAL FINANCE

Formal finance refers to a regulated, structured financial system composed of institutions like banks, credit unions, and insurance companies. Informal finance, in contrast, operates outside official channels, relying on personal relationships and community networks. Each system has distinct characteristics, advantages, and disadvantages, particularly concerning regulation, access, and cost.

Comparison of formal and informal finance

Feature	Formal Finance	Informal Finance
Regulation	**Regulated by the government:** Governed by official banking authorities, like the Reserve Bank of India (RBI) or the Federal Reserve, which ensures transparent and legal processes.	**Unregulated:** Lacks formal government oversight, leaving borrowers with minimal legal protections against exploitation.
Interest Rates	**Lower, fixed interest rates:** Rates are regulated and generally affordable, creating financial stability for borrowers.	**Higher, flexible interest rates:** Rates are often based on personal arrangements and profit motives, making them significantly higher and more arbitrary.
Accessibility	**Stricter criteria:** Requires extensive paperwork, credit history, and often collateral, making it difficult for low-income individuals and small businesses to access.	**Easier, quicker access:** Uses fewer bureaucratic steps and may not require collateral, relying instead on trust and relationships.
Legal Framework	**Legal enforcement:** Loan contracts are legally binding and enforced through the court system, protecting both borrowers and lenders.	**Informal enforcement:** Repayment is often enforced through social pressure or personal sanctions rather than legal means.
Products	**Wide range of products:** Offers diverse services, including savings accounts, mortgages, insurance, and investment options.	**Limited services:** Typically offers a narrower range of financial products, primarily savings and loans.
Credit History	**Builds credit history:** Formal borrowing contributes to an official credit record, which can improve access to larger loans and better terms in the future.	**No credit history:** Informal loans are often undocumented, so they do not help build a credit history for formal lending.
Examples	Banks, credit unions, insurance companies, microfinance institutions, non-banking financial companies (NBFCs).	Moneylenders, family and friends, rotating savings and credit associations (ROSCAs), and community savings groups.

The role of informal finance in developing economies

While often viewed as less desirable, informal finance plays a critical role in developing countries by filling gaps left by the formal system. It is particularly important for:

1. **Rural populations and the poor:** Serves low-income individuals and small-scale farmers who are typically excluded by the formal financial sector.
2. **Small enterprises:** Provides essential financing for small businesses that lack the collateral or credit history required for formal bank loans.
3. **Emergency needs:** Offers faster access to funds for urgent or unforeseen financial needs.

Trends and interactions

Research shows that the formal and informal sectors do not operate in a vacuum. A significant portion of the population in developing economies uses both, a practice known as "co-funding". For small firms, combining the relational advantages of informal finance with the scalability of formal finance can lead to greater growth. However, some studies find that while informal finance is widely used, particularly by younger and lower-income individuals, it does not necessarily lead to higher productivity compared to formal channels.

MICRO FINANCE

Microfinance provides financial services such as small loans, savings, and insurance to low-income individuals and groups who lack access to traditional banking. It is a critical tool for promoting financial inclusion, encouraging entrepreneurship, and empowering marginalized communities, particularly women and the rural poor.

How microfinance works

Microfinance institutions (MFIs) offer a variety of services to help the unbanked and underserved become more financially independent. These services are delivered with minimal collateral and simplified procedures to accommodate low-income clients.

Key elements of microfinance include:

1. **Microcredit:** Providing very small loans (sometimes as little as $50) for income-generating activities. These are often given without collateral and have structured repayment schedules, frequently with a one-year maturity.

2. **Group lending:** A common model where MFIs lend to a group of individuals who are collectively responsible for loan repayment. The group dynamic offers a form of social collateral and support, which helps ensure high repayment rates.

3. **Savings accounts:** Many MFIs offer savings accounts that allow clients to build capital and better manage their finances. In some cases, access to larger loans is tied to a client's successful savings record.

4. **Microinsurance:** Some institutions offer insurance products to protect against risks such as illness or property loss, which can be devastating for low-income families.

5. **Financial literacy:** Many MFIs provide business and financial education to help clients manage their money effectively and increase their chances of success.

Examples of microfinance in action

Microfinance supports a wide range of activities, from providing basic financial services to funding small business endeavors.

1. **Agricultural support:** In Kenya, a farmer received a microloan to buy higher-quality seeds. The resulting increased harvest led to higher earnings, which he could then reinvest in his farm.

2. **Expanded entrepreneurship:** In Rwanda, a small business owner used a microloan to purchase a commercial truck, which allowed her to expand her cereal company and hire more employees.

3. **Traditional crafts:** Micro-enterprises like basket making, sewing, and street vending are often financed through microloans.

Criticisms and ethical considerations

While microfinance is a powerful tool for good, the industry faces criticisms and ethical challenges.

1. **High interest rates:** Some commercialized MFIs are criticized for charging high interest rates that can burden the very people they are intended to help.

2. **Client protection:** There are concerns that some practices do not adequately protect clients from over-indebtedness.

3. **Missions vs. profit:** The growing commercialization of the microfinance sector has led to concerns that some institutions may prioritize profit over their original mission of poverty alleviation.

Future of microfinance

The microfinance industry is expected to grow significantly, largely driven by digital technology.

1. **Digital integration:** The increased use of mobile technology, cloud-based loan management, and automated applications will increase efficiency and allow MFIs to serve more clients.

2. **Fintech solutions:** Financial technology (fintech) is enabling faster, more secure, and more accessible services for remote and underserved populations.

3. **Broader financial inclusion:** Ongoing efforts by governments and international development agencies are expected to further increase financial inclusion and expand the reach of microfinance.

FOREIGN FINANCE

Foreign finance, also known as international finance, is the study of financial transactions and interactions that occur between multiple countries. It is a branch of financial economics that focuses on the monetary and macroeconomic relationships of an integrated global economy.

The field of international finance is of growing importance due to globalization and the deep integration of financial markets. It encompasses a variety of critical concepts and functions for businesses, investors, and governments operating across borders.

Key components of foreign finance

1. **Foreign exchange (Forex) market:** This is the global, decentralized marketplace where currencies are traded. Businesses, governments, and individuals use the forex market to convert one currency into another to facilitate international trade and investment. The exchange rate is the value of one currency relative to another.

2. **Foreign Direct Investment (FDI):** This involves an investment made by a company or individual in one country into business interests located in another country. FDI can include establishing new operations, acquiring a foreign business, or making a substantial stake in a foreign company.

3. **International capital markets:** These are financial markets where entities can trade financial products such as stocks, bonds, and derivatives across national borders to raise capital. Examples include the Eurocurrency and Eurobond markets.

4. **Balance of Payments (BOP):** The BOP is a systematic record of all economic transactions between a country's residents and the rest of the world over a specific period, such as a year.

5. **Risk management:** International finance involves unique risks that must be managed, such as foreign exchange risk (the risk from fluctuating currency values) and political risk (the risk of changes in a foreign country's government policies).

Leading international financial institutions

These organizations play a crucial role in maintaining global economic stability by providing financial support, setting standards, and fostering economic cooperation.

1. **International Monetary Fund (IMF):** An organization of 190 countries that works to promote international monetary cooperation, secure financial stability, and foster

economic growth. It also provides financial assistance to countries facing balance-of-payments problems.

2. **World Bank Group:** A group of international organizations that provides financing, advice, and research to developing nations to aid their economic advancement. The International Finance Corporation (IFC) is a member focused on the private sector.

3. **World Trade Organization (WTO):** An intergovernmental organization that regulates international trade. The WTO provides the framework for trade agreements and a dispute resolution process.

4. **Bank for International Settlements (BIS):** An organization that serves as a bank for central banks and helps coordinate international banking regulations, like the Basel Accords.

Importance and benefits

1. **Global economic growth:** International finance facilitates the flow of capital and investment across borders, which can spur economic growth in both developed and developing countries.

2. **Expansion and diversification:** Companies can expand their operations into new markets, access new consumer bases, and diversify their portfolios to reduce financial risk.

3. **Financial stability:** By providing financial support and policy guidance during economic crises, international finance and its institutions help prevent broader economic collapses.

4. **Resource and technology transfer:** Foreign investments often bring new technology, expertise, and management techniques to host countries, benefiting local industries.

FOREIGN AID

Foreign aid is the voluntary transfer of resources, such as money, goods, or services, from one country or international organization to another, often from developed to developing

nations. It can be economic, military, or humanitarian and is used for a wide range of purposes, including disaster relief, development, and supporting a donor country's interests.

Types of foreign aid

1. **Economic aid:** Financial assistance, which can be provided as grants or loans.
2. **Military aid:** Assistance in the form of equipment, training, or other military resources.
3. **Humanitarian aid:** Support in response to emergencies or natural disasters, often including food, water, and medical supplies.

Purposes of foreign aid

1. **Economic development:** Supporting infrastructure, health, education, and economic growth in recipient countries.
2. **Humanitarian relief:** Providing assistance during and after natural disasters, conflicts, or other crises.
3. **Political and strategic interests:** Influencing a recipient country's government or supporting a donor country's own strategic goals.

How foreign aid is delivered

1. **Bilateral aid:** Direct assistance from one government to another.
2. **Multilateral aid:** Contributions from multiple governments to international organizations, such as the United Nations or the World Bank.
3. **Non-governmental aid:** Support from non-governmental organizations (NGOs), charities, and foundations.

FOREIGN AID THE DEVELOPMENT ASSISTANCE DEBATE

The foreign aid debate centers on its effectiveness, with arguments that it can stimulate economic growth and governance reforms, while critics argue it can foster dependency, corruption, and conflict. The impact of aid is heavily dependent on the recipient country's

political and institutional environment, and different types of aid (e.g., project vs. budget support) can have varying results. Some studies show a weak or inconclusive link between aid and economic growth, even in countries with good institutions, highlighting the complexity of the issue.

Arguments for foreign aid

1. **Economic growth:** Aid can stimulate economic growth, particularly when it's targeted at sectors like education, healthcare, and agriculture, and when institutional quality is high.
2. **Poverty reduction:** Aid has been linked to improvements in poverty, food insecurity, and child mortality, especially in countries with effective implementation.
3. **Governance and stability:** Development assistance can provide incentives for recipient countries to establish good governance, promote democracy, and improve political stability.

Arguments against foreign aid

1. **Dependency and corruption:** Aid can create a culture of dependency, institutional corruption, and clientelism, potentially hindering long-term development.
2. **Ineffectiveness:** Some research suggests that aid has a negligible or even negative impact on economic growth, regardless of institutional quality.
3. **Misallocation:** Aid money can be used for non-developmental purposes, or it can be misspent due to a lack of proper oversight.
4. **Distortion of markets:** Aid can sometimes distort local markets, making it difficult for domestic businesses to compete.

Factors influencing aid effectiveness

1. **Institutional quality:** Aid is generally more effective in countries with strong institutions that can effectively implement strategies and manage funds.

2. **Type of aid:** The type of aid matters; for example, some studies find positive effects from energy and education aid, while others find negative effects from humanitarian aid. Loans versus grants also impact effectiveness.
3. **Donor motives:** Aid can be influenced by donor country interests, and the way it is delivered can affect its impact.
4. **Implementation:** The way aid is implemented is crucial; for instance, the complexity of current aid programs can make it difficult to track and evaluate their impact.