PREFACE

In the curricular structure introduced by this University for students of Post-Graduate degree programme, the opportunity to pursue Post-Graduate course in a subject is introduced by this University is equally available to all learners. Instead of being guided by any presumption about ability level, it would perhaps stand to reason if receptivity of a learner is judged in the course of the learning process. That would be entirely in keeping with the objectives of open education which does not believe in artificial differentiation. I am happy to note that university has been recently accredited by National Assessment and Accreditation Council of India (NAAC) with grade 'A'.

Keeping this in view, the study materials of the Post Graduate level in different subjects are being prepared on the basis of a well laid-out syllabus. The course structure combines the best elements in the approved syllabi of Central and State Universities in respective subjects. It has been so designed as to be upgradable with the addition of new information as well as results of fresh thinking and analysis.

The accepted methodology of distance education has been followed in the preparation of these study materials. Co-operation in every form of experienced scholars is indispensable for a work of this kind. We, therefore, owe an enormous debt of gratitude to everyone whose tireless efforts went into the writing, editing, and devising of a proper layout of the materials. Practically speaking, their role amounts to an involvement in 'layout of the materials. Practically speaking, their role amounts to an involvement in 'invisible teaching'. For, whoever makes use of these study materials would virtually derive the benefit of learning under their collective care without each being seen by the other.

The more a learner would seriously pursue these study materials, the easier it will be for him or her to reah out to larger horizons of a subject. Care has also been taken to make the language lucid and presentation attrative so that they may be rated as quality self-learning materials. If anything remains still obscure or difficult to follow, arrangements are there to come to terms with them through the counselling sessions regularly available at the network of study centres set up by the University.

Needless to add, a great deal of these efforts is still experimental—in fact, pioneering in certain areas. Naturally, there is every possibility of some lapse or deficiency here and there. However, these do admit of rectification and further improvement in due course. On the whole, therefore, these study materials are expected to evoke wider appreciation the more they receive serious attention of all concerned.

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Netaji Subhas Open University
Post Graduate Degree Programme

MA in Economics
Course : Development Economics
Course Code : PGEC-X

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PG : ECONOMICS (PGEC)

PGEC-X : Development Economics

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Unit 1 ❑ Macro Perspective of Development

Structure

1.1 Objectives

1.2 Introduction

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1.4 Industrialization and Balanced Growth

1.5 The Problem of Coordination Failures

1.6 Conclusion

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1.9 References

1.1 Objectives

After studying this unit, you will be able to :

- understand about vicious circle of poverty;
- demonstrate three distinct approaches to industrialization along with the idea of balanced growth doctrine and to know how India's experience of industrialization differs from Brazilian and Korean approach; and
- have a broader idea about how is the theory of coordination failure widely used at the present by development economists to define a new case for industrial policy.

1.2 Introduction

Economic development is the movement of an economy from agricultural activities using simple technology to the production of industrial products and a range of services

using modern technology. (Even three centuries ago Sir William Petty (1623-87) regarded development as the growth of service industries).

Amartya Sen has argued, development is about enlarging the capabilities that people have to lead lives they value, or human development. He has highlighted the alternative approaches to development and his book "Development as Freedom (1999)" has presented a view of development which sees the enhancement of human freedom as both the main object and the primary means of development. Here he has raised the following question: "Is development to be seen as economic growth : the expansion of say, GNP or national income? Or should we go beyond all this? " He answers that development is the process of acquiring and securing the freedoms that we have reason to value. In that sense economic development involves the removal of 'unfreedom' such as poverty, lack of access to public infrastructure, or denial of civil rights.

1.3 The Idea of Vicious Circle of Poverty

The well-known idea of vicious circle theory, associated with the names of Hans Singer (1949) and Ragnar Nurkse (1953), tries to explain the continuing and self-perpetuating low incomes in an underdeveloped economy, by a mutually reinforcing circle. It postulates a circular relationship between lack of capital, income and savings thus: Low incomes — Low capacity to save — Low capital — Low productivity and low incomes (Fig **1.1**). The basic idea underlying the concept of the vicious circle of poverty can be aptly summed up in the proposition, “A country is poor because it is poor”. According to the definition given by Ragnar Nurkse, the vicious circle of poverty “implies a circular constellation of forces tending to act and react upon one another in such a way as to keep a poor country in a state of poverty.”

Figure 1.1 shows the basic concept of vicious circle of economic underdevelopment in the form of the self-feeding circular mechanisms operating in an underdeveloped economy.

1.4 Industrialization and Balanced Growth

Industrialization is a successful strategy of economic development in the Third World. In fact, all the Asian success stories are stories of industrialization. Three distinct approaches to industrialization have been identified which have different characteristics

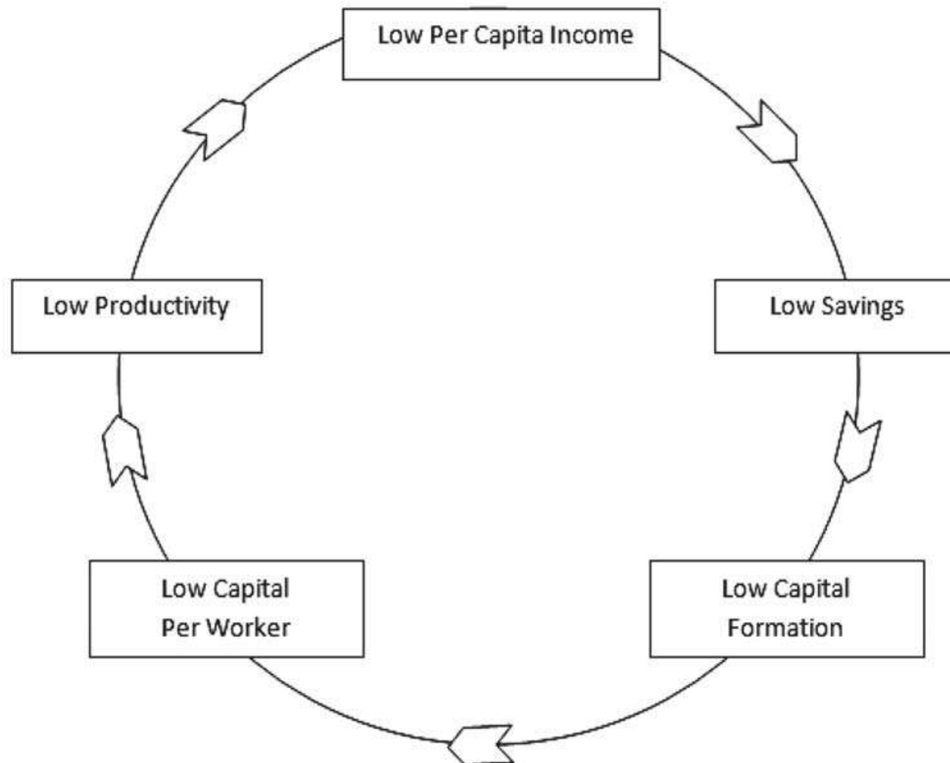

Fig 1.1: Vicious Circle of Economic Underdevelopment

and consequences. The **first** is to concentrate on replacing the imports of manufactured consumer goods by domestic manufactures. This is the well known strategy of import-substitution industrialization. This strategy has been implemented within the context of a mixed economy and although direct state investment in industrial enterprises is not uncommon, most investment in manufacturing has been undertaken by the private sector. High tariffs, sometimes supplemented by quotas and other-non-tariff barriers to trade, have been universal. In addition, multiple exchange rates have been used both to encourage " non-traditional" exports and to discourage imports of consumer goods. Let us call this approach the Brazilian approach.

There is however a **second** approach to industrialization in the Third World that merits attention. This approach was devised to enable a country to industrialize under conditions of stagnant or slowly growing exports. Under such conditions the foreign exchange needed to import capital goods to sustain a high rate of investment is not available. And consequently the country must either reduce its growth ambitions to the

rate permitted by export earnings or it must develop its own capital goods sector. The Indian statistician and planner, P.C. Mahalanobis, clearly influenced by the then Soviet experience in the mid 1950s, designed a development strategy for India that was spearheaded by the development and expansion of the capital and intermediate goods industries within a semi-closed economy. This we shall call the Indian model.

The **third** approach— South Korean model — is based on planned exports of consumer goods within a policy environment that ensures that domestic and international prices remain broadly aligned.

Balanced Growth or Unbalanced Growth

A key problem for a less developed country concerns the " balance" to be preserved between the different sectors of its economy or that country will focus its attention on unbalanced growth path. These are among the most important and deeply debated issues. Though both the doctrines –balanced growth and unbalanced growth – admit that there is a significant interdependence between the different sectors of the economy, the conclusion from these two doctrines differs significantly. From the balanced growth doctrine, the conclusion that comes is that: the country must achieve advancement simultaneously over a broad range of activities. Given interdependence, any isolation effort is likely to fail. The inter sectoral demand and supply linkages ensures such balanced growth. The critics of this thesis, however, proceeding from the same fact, reach exactly the opposite conclusion. Thus, for example, A.O. Hirschman argues that the linkages between different industries provide a good reason for concentrating on certain specific areas of the economy. By building up one stage or sector of industry, the country will set up heavy demands for productive increases in the lagging part. While the balance growth theorists like Paul Rosenstein-Rodan, Nurkse and others try to *ease tensions* by establishing a harmonious, overall pattern of development, Hirschman, the ardent advocate of uubalanced growth doctrine urges *creation of tensions* between different parts of the economy. The forward and backward linkages are crucial in the growth process.

The Theory of Balanced Growth and Industrialization

In what follows, balanced growth means equal development in all sectors of the economy. It is the situation of the economy in which economic activities are conducted

and expanded in balanced ways. Government should make a simultaneous investment to all sectors to achieve balanced growth. Balanced growth, therefore, requires balance between different consumer goods industries, and between consumer goods industries and capital goods industries. It also implies a balance between industry and agriculture, and between domestic and export sector. In development economics, *balanced growth theory* has emphasized that a dynamic agricultural sector is crucial to successful industrialization.

Paul Rosenstein-Rodan was among the first to articulate an explicit development agenda in his 1943 article 'Problems of industrialization of Eastern and South –Eastern Europe'. He highlighted the need **for a big push** to get development going. This he believed could be achieved through large scale planned investment in industry in post-war economies and by taking advantage of surplus labour which would leave agriculture, as it and industry became more mechanized and benefited from economies of scale. While the focus was on Europe, the theory was general with him suggesting that such processes could ultimately equalize world incomes.

In 1953, Ragner Nurkse's *Problems of Capital formation in Underdeveloped Countries* emphasized the importance of capital formation and advocated the theory of the big push to break the vicious cycle of poverty in developing countries. The crux of the problem, for Nurkse, was that capital accumulation is held back by the size of the market. Poor countries remained poor due to the vicious circle of poverty which needed to be unlocked through a big push of investment. Mild investment push would not suffice to counter high population growth in LDCs. His **'law of balanced growth'** requires simultaneous investment in multiple industries and sectors to enlarge markets, increase productivity, create incentives for private enterprises. Nurkse propounded the view that growth should take the form of the coordinated and simultaneous investment to a wide range of industries.

W.A. Arthur Lewis, a West Indian economist, strongly influenced development thinking. In his 1954 paper *Economic Development with Unlimited Supplies of Labour*, he argued that a rise in the rate of investment is required for the for the transition to growth. According to Lewis the central challenge in economic development is increasing the rate of capital accumulation and investment. In the Lewis **dual-economy** model a shift in resources from the subsistence to modern sector increases profits and raises savings, and thus investment. The two-sector closed economy model called Lewis-Fei-Ranis model speaks that the growth of the industrial sector increases demand for the

agricultural sector's produce and attracts labour from the low-productivity agricultural sector thus raising overall output and productivity of the economy as a whole. (*Fei and Ranis*,1965), keeping the agricultural wage rate unchanged.

In 1960, W.W. Rostow published *The Stages of Economic Growth: A Non-Communist Manifesto*, in which he identified distinct stages of development. These were: first, traditional society, secondly the preconditions for take-off, thirdly the take-off, fourthly the drive to maturity, and fifthly the age of high mass consumption. For Rostow, the take-off stage is the turning point and occurs when economic activity reaches a critical level and leads to: a rise in productive investment from around 5 to about 10 % of national income, the development of high-growth manufacturing sector, and the emergence of social, political and institutional arrangements that supports the modern sector.

In summary, for modern industrial development to be viable, various industries should be simultaneously promoted so that they could create markets for each other (for example, employees of shoe manufacture would purchase shirts while those of the shirt manufacturer would purchase shoes)— a perspective recently being renovated as the theory of' complementarity' among various industries (Murphy et al..1989, Bardhan,1995: 2292-8).

The 'balanced growth' or simultaneous development of many industries would require mobilization of large amount of resources at one time. This is the key to the success of balanced growth strategy. According Rosenstein-Rodan and Nurkse, poor developing economies were characterized by a large surplus of labour employed at zero marginal cost in the traditional sector (similar to the dual economy model of Lewis-Fei-Ranis model). Under this assumption of disguised unemployment, the labour supply would create no major bottleneck to a 'great leap forward' in industrialization.

The Theory of Unbalanced growth

A leading German- born development economist, A.O Hirschman has taken the unusual path of advocating **unbalanced** economic development, based on key industries, for example, —automobile and steel — producing intermediate products. Actually he identified the importance of certain industries which have particularly dense linkages with other industries. The implication was that promoting such industries would enable to go grow faster. For Hirschman, the goal was to encourage '**unbalanced growth',** and investment in industries with the greatest number of 'forward' and 'backward' linkages.

Hirschman identified four types of linkages: *forward* linkages (when investment in a particular project encourages investment in subsequent stages of production, *backward* linkages (when projects encourage investment in infrastructure), *consumption* linkages (when rising incomes stimulate the production of consumer goods) *and* fisca*l* linkages (when surpluses arising from one sector, such as agriculture, are taxed by the government to promote industrial development). These linkages were seen as powerful arguments to support notions of import substitution and for state intervention to protect and nurture 'infant' industries.

Hirschman also argued that both SOC (Social Overhead Capital) that comprises of those basic devices without which primary, secondary and tertiary activities cannot function) and DPA (Direct Productive Activities [which are consequences of some investment, add to the flow of final goods and services] cannot be taken up simultaneously in less developed countries, owing to the general lack of resources. Initially, the country should concentrate on either of the two, the other one would be automatically stimulated.

Thus it appears from our above discussion is the fact that at the present moment, the debates between balanced growth and unbalanced growth remains unsettled, and the debate will probably continue for many years to come. Experience gives no certain guide in this matter although it does seem clear that exclusive attention to industry following unbalanced growth doctrine will necessarily require a fairly tight control over the economy as a whole.

1.5 The Problem of Coordination Failures

The theory of coordination failure is widely used at present by development economists to define a new case for industrial policy.

Marshall (p. 13-14) provides a good explanation of what is meant by coordination failure: Suppose the economic performance of a country (or a firm, industry, or financial market) depends on large number of investors being willing to provide funds. If it is generally believed that other investors will withhold funds, it is rational for any given investor to refrain from investing. Thus, these beliefs become self-fulfilling. This represents a coordination failure because everyone would be better off if all investors provided funds to the affected country.

The central pillar of the literature on coordination failure is the idea that economy can fail to achieve coordination among complementary activities. Coordination failure leads the market to an outcome (equilibrium) inferior to a potential situation where resources would be correctly allocated and all agents would be better off. The occurrence of these inefficient equilibria or poverty traps is supposed to provide an opportunity for a positive state intervention. It is argued that such situations can be overcome only by massive coordinated investments, something which is unlikely to happen if poor regions are left on their own. As Dercon (2003, p. 5) puts it, “A poverty trap is an equilibrium outcome and a situation from which one cannot emerge without outside help, for example, via a positive windfall to this group, such as by redistribution or aid, or via a fundamental change in the functioning of markets.” In a few words, poverty traps can be removed by a “big push” strategy.

“The big push has returned to favor in the development policymaking , after half a century of exile” (*Easterly 2005*, p. 3). A good illustration of this change is the adoption of Millennium Development Goals by the U.N. However, “Big push” policy as innovated by Paul Rosenstein-Rodan in 1943 is back in development economics because in the last decades a number of contributions have attempted to refine the case for industrial policy.

A reference work illustrating the resurgence of interest for coordination problems is Murphy, Shleifer, and Vishny (1989) which formalized some aspects of the Rosenstein-Rodan viewpoint. In fact, they explored Rosenstein-Rodan’s idea that simultaneous industrialization of many sectors of the economy can be profitable for them all even when no sector can break even industrializing alone. They analyzed this idea in the context of an imperfectly competitive economy with aggregate demand spillovers and interpret the big push into industrialization as a move from a bad to a good equilibrium. They present three mechanisms for generating a big push and discuss their relevance for less developed countries. In addition, other development economists have emphasized a number of situations where interdependence among private agents seems to produce coordination failures that prevent economies from achieving a better equilibrium.

Economists like Sachs (2004), Rodrik (1996) and Rodriguez-Clare (2005;) have used this particular market failure argument as justification for a “new industrial policy”, the goal of which is to induce entrepreneurs to invest in those projects with the highest social return.

Coordination problems typically arise when “profitable new industries fail to develop unless upstream and downstream investments are coaxed simultaneously” (Rodrik 2004, p. 13). For example, “building an airport in a region that has no hotels would not lead to any traffic, but hotels without a regional airport may not be profitable either”.

1.6 Conclusion

In what follows is the fact that we have traversed a long way from the development paradigm goals as advocated by Ragnar Nurkse, Rosenstein-Rodan and Rostow,Lewis and Hirschman, to the coordination failure as advanced by modern economists like Easterly, Murphy, Shleifer, and Vishny (1989), Rodrik and others and eventually we have come to the conclusion that there is no unique theory that would surely augment economic development. All it depends on the problems of the countries concerned and the ideal way to look into it from macro perspectives.

1.7 Summary

Vicious Circle of Poverty: According to the definition given by Ragnar Nurkse, the vicious circle of poverty “implies a circular constellation of forces tending to act and react upon one another in such a way as to keep a poor country in a state of poverty.”

Export pessimism: A belief that the terms of trade were likely to move against primary export commodities.

Balanced growth doctrine: Growth of different sectors of an economy at the same rate. This has been advocated by many development economists as a strategy, for example, Ragnar Nusrkse propounded the view that growth should take the form of the coordinated and simultaneous application of capital to a wide range of industries so that the national economy would not be a mixture of expanding, declining and stationary sectors.

Big push theory: A theory of simultaneous economic development in several sectors. Rosenstein-Rodan asserted that for economic development to succeed there should be, as minimum, several large investment projects in different industries in order to secure

increasing returns to scale from indivisibilities in production. It was hoped that the scale of such development would reduce divergences between private and social products. However, the lack of resources of many Third World countries made it unlikely that so ambitious a scheme would be implemented.

Coordination failure: Coordination problems typically arise when "profitable new industries fail to develop unless upstream and downstream investments are coaxed simultaneously".

1.8 Exercises

A. Small-answer type questions

1. What is export pessimism?
2. What is balanced growth doctrine?
3. What was Hirschman's view regarding unbalanced growth?
4. How did Murphy, Shleifer, and Vishny (1989) explore Rosenstein-Rodan's idea?
5. When does co-ordination failure arise? Give example.

B. Medium-answer type questions

1. Explain the idea of vicious circle of poverty.
2. Should a country attempt to achieve a generally balanced growth or should it go in for unbalanced growth ?
3. Write a short note on: (i) balanced growth and (ii) big push doctrine.
4. What is the rationale behind the state led development strategy?

C. Long-answer type questions

1. Write down Indian experience with industrialization since the mid-1950s.
2. Elucidate the central pillar of the literature on coordination failure.

3. “The big push has returned to favour in the development policymaking, after half a century of exile.” Do you agree? Illustrate.

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Unit 2 ❑ Rural Economy

Structure

2.1 Objectives

2.2 Introduction

2.3 Rural Employment

2.4 Rural Credit

2.5 Credit-Labour Interlinkage

2.6 Agriculture and Rural Industrialization

2.7 Non-farm Sector Growth

2.8 Rural Credit and Microfinance

2.8.1 Why Doesn't Microfinance Work?

2.8.2 Factors to Future Success of Microfinance

2.9 Conclusion

2.10 Summary

2.11 Exercises

2.12 References

2.1 Objectives

After reading this unit, you will be able to:

- Understand what rural economy actually means and who are the rural poor within the rural economy;
- Learn about importance and status of rural non-farm jobs in India;
- Have some idea about rural credit, its importance and types;
- Explore the credit-labour interlinkage and credit-product interlinkage observed in backward agriculture.

- Explain how the agriculture and industry linkage have been undergone tremendous changes over the years, along with have a snapshot of importance of rural industrialization;
- Know about Non-farm sector and its growth in a developing country like India; and
- Also to know about microfinance- its importance and operation.

2.2 Introduction

Although the statistics and methods of computation in regard to rural people living below the poverty line in the world are often open to debate, it is true that a substantial proportion of the world's poor lives in and depends upon the rural environment for their livelihoods.

Apart from the geographical concentration of poverty in rural areas, there are also regional characteristics. Asia experienced rapid economic growth, but it is primarily in East Asia that export-led growth has contributed to poverty reduction. Sub-Saharan Africa presents a more pessimistic profile: overall numbers of the poor have increased both absolutely and proportionately, the depth of poverty has also intensified and economic growth has been weak in many countries. In Latin America and the Caribbean, political instability, currency movements and international market fluctuations have adversely affected the rural poor. However, poverty has become a major threat to a safe and investment-oriented national and international environment.

An external variable impacting upon the rural poor has been structural reform, trade liberalization and globalization, particularly of commodity markets, which in turn has led to increased indebtedness,. It is widely acknowledged that the rural poor, in particular, have been adversely affected in terms of their weaker purchasing power, lack of quality inputs etc. There have been powerful vectors of rural differentiation, erosion of livelihoods systems, marginalization, and disempowerment of men and women. Worsening socioeconomic profiles between the rural and urban areas, particularly in terms of public goods, such as healthcare and education, and income earning opportunities are in evidence.

Who then are the rural poor within rural economy? They belong to a constellation of tragic trajectories of livelihoods-decline families who typically are the group of small or marginal farmers, landless labourers, nomadic pastoralists, artisans or fishermen.

2.3 Rural Employment

Eight out of ten of the world's working poor who live on US$1.25 per day live in rural areas, where many are caught in vulnerable employment. Flourishing rural areas are vital to regional and national development. Yet, rural economies tend to face a wide range of challenges that urban areas are more likely to overcome. These include access to transportation, sanitation and health services, and a consumer base in close proximity to support small and medium enterprise development. Women and men working in rural areas also face difficulties associated with a paucity of economic opportunities, under investment, poor infrastructure and public services, including education, and, in many cases, weak governance and underdeveloped markets.

The non-farm sector is substantial in many countries — both in terms of income and employment — and has, in the aggregate, been growing over time. For example, in China, non-agricultural employment grew from 11% of total rural employment in 1980 to 20% by 1986. Over the years, the rural non-farm sector has been gaining importance in providing gainful employment and additional income opportunities to the growing rural workforce. Occupational diversification away from farm activities, that is, agriculture and allied activities in favour of rural non-farm activities has generated a lot of interest among researchers; therefore it is interesting to understand the status and growth of rural non-farm employment in India.

Rural non-farm jobs fall into three major categories spread across a variety of industries—regular formal jobs, casual labour and self-employment. Over the past decade, the trade, construction and transportation sectors have driven non-farm job growth. Across both industries and types of jobs, some clear trends are emerging:

(i) **Decline in salaried jobs**: Employment in the formal, organized sector has declined over time. This is a cause for concern because formal sector jobs (particularly government jobs) bring greater job security, assurance of minimum wage, and benefits like health, insurance and pension. Growth in government

jobs has been limited. Any expansion—such as teachers or staff for the implementation of programmes such as the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS), Integrated Child Development Services (ICDS) scheme, and NRLM (National Rural Livelihood Mission-Aajeevika—has often been based on contracts rather than on permanent staff. The formal private sector saw no job growth between 1999–2000 and 2009–10 and beyond. Manufacturing, the largest source of non-farm income and employment in rural areas through the 1990s, did not create enough jobs during the post-liberalization period of high growth.

On the other hand, the contributions of agro- based and labour-intensive industries such as food products, textiles and leather have declined over time. Even the limited number of jobs created in the formal private sector is mostly on a contract basis.

(ii) **Status of self-employment in unorganized-manufacturing:** Self-employment in unorganized-manufacturing such as food processing, non-metallic mineral products (such as glass, ceramics, tiles, clay and finished stone), textiles, furniture, and apparel, including traditional artisans is declining.

(iii) **Marked casualization of the Labour force:** A striking feature of non-farm employment is the casualization of the labour force. Today, two out of three new rural non-farm jobs are casual workers, i.e. unskilled daily wage jobs. The wage gap between regular employment and casual labour has also narrowed. The main demand for casual labour has come from the construction industry, which has now overtaken manufacturing as the highest provider of non-farm employment.

2.4 Rural Credit

Rural credits serve as a tool for providing a sustainable livelihood for millions of **rural** people who don't have a means of livelihood. In India, several organizations like RRBs (Regional Rural Banks), Microfinance Institutions, NABARD, etc. are playing a major role in providing rural credit facilities to rural India. Non-institutional sources comprise moneylenders, landlords, relatives etc.

Types of Rural Credit

The rural credit is divided into three types of credit.

- **Short Term Loan/Credit-** A short term loan is one kind of rural credit that is taken to hold a brief private or business capital requirement. It is that type of credit, that requires a borrowed principal amount and interest percentage to be repaid at a given date, the course of which may be maximum up to one year. A short term loan is a worthy but expensive option.
- **Medium-term Loan/Credit-** Medium-term loans are the loans that have a repayment duration between one to five years. Medium-term loans are an excellent option for small farms who are looking for a traditional way of credit with a set repayment duration and anticipated amounts.
- **Long term Loan/Credit-** The repayment duration of the long-term loan is usually 5 to 20 years or even more in a few exceptional cases. In any business, long-term finance is essential, to create permanent assets that will return over a period of time. Especially in the Agriculture sector, long-term investment comprises of land leveling, fencing, sinking well, permanent repairs on land, acquisition of heavy machinery such as tractor, etc. All the long-term investments suggested above need large amounts of funds. Although they have considerable potential to give profits in the future, private farmers do not have their own money to make such costly investments because either they have no savings or have very little savings.

2.5 Credit- Labour Interlinkage

Krishna Bharadwaj in 1974 and Amit Bhaduri in 1973 had talked about interlinkage. But in Bharadwaj interlinkage is simply mentioned without any supporting empirical evidence or theory. Likewise in Bhaduri interlinkage is a ‘given’. His focus lay elsewhere: to use the assumption of interlinkage to derive an explanation of technological stagnation in certain agrarian economies. The modern study of agrarian relations through the eighties and after is one area where theoretical and empirical work has blended extremely well. In response to the theoretical research of the eighties began a second round of empirical research. This second wave of empirical research has given us a plenty of insights on agrarian relations (Basu, 1994).

On sharecropping, credit markets, labour markets including bondage, a large literature has emerged from India. But we will discuss here, in a nutshell, what is all about in regard to credit – product linkage, specifically credit – labour linkage.

The literature on agrarian contracts in less developed countries (LDCs) including India highlights the presence of 'interlinked' markets. Transactions in any one market are invariably linked with the nature and amount of transactions in other markets. While, theoretically, interlinkages may be of various kinds, the most commonly observed ones are those involving the informal (agrarian) credit market and the labour markets, etc. It is often found also that with the same producer, there is simultaneous existence of credit-product interlinkage and credit-labour interlinkage.

Recent developments in interlinked literature consider interlinked contract as a collateral substitute and an effective monitoring and contract enforcement device by reducing information asymmetries.

What makes the problem of interlinkage interesting is the diversity of relations among the various markets in LDC agriculture. In addition, particular instances of agrarian contracts have been variously interpreted by political economists as examples of exploitation and power. To be able to resolve the debate, it is essential to know the major empirical facts in agrarian economies.

First, how do we identify interlinkage? Let us consider two markets dealing in two commodities A and B. There are agents operating on both sides (i.e. as buyers and sellers) of the two markets. Let us suppose that there are some agents who are common to both markets. If it is observed that (even one of) such common agents transact at different prices different from those operating in one of the markets only, we will say that there is interlinking of markets by common agent(s).

Two types of interlinkages are observed in a backward agriculture : (i) Credit-labour interlinkage which implies that the agricultural worker takes loan from his employer and (ii) Credit–product interlinkage implying that the producer takes loan from the trader to whom he sells at least a part of his product. In the first case, the landlord finds an interlinked credit-labour contract profitable when the consumption– loan given to the worker increases its productivity.

Let us consider, for example, *the credit – labour interlinkage*. There is a market rate of interest for various types of loans and a market wage rate for various types of labour. However, it is often observed that when the lender is also a landowner and

lends to a labourer who works on the landowner's land, neither the rate of interest nor the wage rate is the same as the corresponding market rates. This is a clear case of an interlinked contract entered into by the landowner (lender) and the labourer (*Gangopadhay*, 1994)

2.6 Agriculture and Rural Industrialization

In recent years, the pinch of lower agricultural growth has been felt, in varying degree, by all types of rural industrial activities. The severest setback is faced by the group of traditional industries, most noticeably khadi, handloom, sericulture and handicrafts. But then, even the modern industrial activities have not escaped the damaging effects of slower agricultural growth.

Looking back into the growth profile of Indian agriculture, and its linkages with the rural industrial sector, it is clear that the nature, content and the geographical spread of these linkages have undergone tremendous changes over time. To say the least, the rural industrial sector today is remarkably different from what it was, say, thirty years back. Structurally, it is no more a bunch of traditional cottage enterprises alone; nor is it dominated any more by rural crafts and house-hold based tiny agro-processing enterprises. The rural industry today consists of two distinct segments: traditional and modern. Village industries, khadi, handloom, sericulture, handicrafts and coir make up the bunch of traditional segment and small scale industries and powerloom come under the modern segment.

Rural Industrialization means encouraging location of large and small scale units away from urban areas or planned shifting of units from urban areas to rural areas. **Rural** industrialization aims at all-round development of an area as well as people living in such areas.

Rural industrialization plays a pivotal role in the economic development of a country. It is generally held that economy under rural industrialization not only raises per capita income and living standards of the people by providing gainful employment opportunities but also reduces income disparities between rural and urban areas. Moreover, promotion of rural industries provides an ample opportunity for optimum utilization of local resources to serve the local needs, Rural industrialization has become one of the major economic and social goals of economic development and formed part and parcel of planning and development. The objective of rural industrialization implies widely dispersed on a small

scale with as high an employment potential as is compatible with an efficient technique and the requirement of process of development. Rural industries developed on proper lines can serve as an effective means of reducing imbalances between the rural and urban sector and also play a prominent role in providing subsidiary occupations and supplementary incomes especially to personnel engaged in the agriculture. Rural industrialization may be looked upon as a process confined to the development of village industries. Rural industrialization fulfills several economic and social needs of rural areas such as increasing employment opportunities, diversifying rural occupations, raising income and living standards of rural communities, reducing exodus to urban centres, eliminating regional and economic imbalance and ensuring social justice. Nevertheless, rural industrialization which does not benefit the rural population is not the best way of rural development. So a comprehensive rural industrialization strategy has to be designed within a broader regional development perspective that does not fail to include employment generation as well as to provide an opportunity to the local labour to be , at least, prepared as their advantaged urban counterparts elsewhere.

What ails the traditional rural industries? The general list of problems is well known, and has been a matter of debate for a long time. Lack of adequate and timely availability of credit, non-availability and/or scarcity of raw materials and other inputs such as power, road and transport network and other infrastructure, unfriendly rules and regulations, wide-spread corruption, restricted market outlets, etc., come under one set of problems. A weak technological base and lack of concern for quality control and product development make the second set of problems. Limited product market, largely confined to the weaker sections of the rural community who themselves suffer from unpredictable fluctuations in their employment and earnings, poses another formidable problem. A poor quality of the work-force is perhaps the most stumbling constraint that the rural industry faces today.

What kind of linkages have been operating between agriculture and industry? One can look into these linkages at different levels. However, there are three alternative ways of looking at these linkages, one in relation to the bunch of village and small industries (VSI), second in relation to the group of small scale industries (which reflect, in a large measure, 'modern' industrial activities in the VSI sector, and third in relation to the domineering unorganized segment of agro-processing manufacturing.

Agriculture has been playing a crucial role in the expansion of the rural non-farm sector, in general, and rural industry, in particular. The rising quantum of agricultural output,

especially the steadily expanding cultivation of commercial crops, has strengthened the forward linkages between agriculture and industry, most noticeably a wide variety of food-processing activities. On the other hand, under the backward linkages, certain types of industrial goods and services, coming in as agricultural inputs, are produced on a somewhat larger scale, say, in a district town or a distant industrial locale, presumably because the industry's own economies of scale are best realized in its present location.

2.7 Non-farm Sector Growth

In this section we will discuss the need for rural non-farm sector, along with its importance, significance and its role in cross –country context. Next we will identify the main driving forces behind the growth of rural non-farm sector.

The rural non-farm sector has traditionally been viewed as a low-productivity sector which produces low quality goods. It is often expected to wither away as a country develops. Recent years have seen a shift away from this position towards recognition that the rural non-farm sector can, and often does, contribute to economic growth, rural employment, poverty reduction, and a more spatially balanced population distribution as well as sustainability of natural resources, gender, food security and prevention of rapid or excessive urbanization. There are ample evidences that in many countries the sector is expanding rather than declining.

The experience of economic growth across countries suggests that high agricultural growth is generally accompanied by the growth of the rural non-farm sector owing to the forward and backward linkages with agriculture. The experience in Asia during the post-reform decades of the 1980s and 1990s provides a mixed picture regarding the growth of the rural non-farm sector. These experiences seem to be largely country-specific.

China, for example, experienced an exceptionally high growth in both farm and rural-non-farm sectors during the post- reform decade of the 1980s, in contrast to India, which showed a reasonably high growth in both the farm and rural non-farm sectors during the pre-reform decade of the 1980s but a slowdown in agricultural growth with little change in the growth in rural non-farm sector during the post-reform decades of the 1990s. On the other hand, there is no evidence of a take-off in the rural non-farm sector in Thailand despite the impressive growth of its agriculture during the 1970s and

1980s under a relatively liberalized environment. On the other hand, Latin America has experienced rapid urbanization and now has an urban population of about 70%. The rural non-farm economy in Latin America is characterized by large varieties of non-farm activities and inequitable access to the benefits of development. But policy initiatives to give priority to human capital and infrastructural development and locational aspects, as well as some pro-poor distributive measures have contributed to the beneficial impact on the poor. On an average, some 40% of the rural incomes come from non-farm activities; service sector accounts for a large share of the non- farm income and wage income exceeds self-employment income. The Latin American experience points, inter alia, to the need to look beyond the traditional focus on small –scale manufacturing in the rural areas as the non-farm sector evolves. The services sector has emerged as an important component of the rural non-farm sector. In Latin America, for example, policymakers often look to rural non-farm economy as an engine of growth precisely where agriculture is not viable, poverty and poor education are widespread, and where other engines of growth are difficult to discern (*Lanjouw & Proctor,2005).* However, common to all these experiences is the overriding importance of yield-increasing and labour-releasing agricultural growth as well as the availability of infrastructure in triggering off the growth in the rural non-farm sector. A rise in the rural demand for non-agricultural goods and services, and the easy availability of labour and the necessary infrastructure for the production of such goods and services seem to be the key factors underlying the growth of the rural non-farm sector (*Rao,2005*)

Need for Rural Non-Farm Sector

- Contribution of agriculture to GDP in most of emerging developing countries is steadily declining. Hence a need for the growth of rural non-farm sector.
- Even the average size of agriculture land holding declining. This explains the rise of employment in the Non-Farm Sector.
- Reducing the dependence of rural masses on agriculture as a source of income and enhancing the enlargement of rural-non farm sector will help improve the overall income of rural population.
- If a growing rural economy is looked at as a farm:non-farm continuum, most of the production and marketing parameters in agriculture influence those in the

rural non-farm sectors, and vice versa. Most significantly, the rising wage rates, under the spell of a fast growing agriculture, raise the opportunity cost, and hence wage rate, of labour in non-farm activities including rural industry.

Role of Rural Non-farm sector

The role of rural non-farm sector is crucial in generating productive employment and alleviating poverty in rural areas because of the limited absorptive capacity of the urban sector and near saturation of the agricultural sector in the further absorption of workers.

Significance of Non-farm Sector

Since agriculture cannot absorb all the growth in the rural workforce, the crucial role of non-farm activities in rural livelihoods was recognized in the 1980s. In the last two decades growth in non-farm work accelerated. Non-farm sector is the source of most new rural jobs. Many have debated the issue of what has driven non-farm job growth over the past three decades.

What is driving force behind non-firm sector growth?

A variety of factors were identified as explaining concentration of rural non-farm activity in particular regions of the country, such as the inter-linkages between agriculture and nonagricultural activity. This hypothesis emphasized the forward and backward linkages of the rural non-farm sector with the agriculture sector, whereby growth in agriculture increases demand for non-farm inputs and vice versa. Researchers observed that the performance of the rural industrial sector in certain states broadly related to agricultural productivity and in some cases higher consumption and input intensity accounted for higher income in agriculturally productive states. Micro studies found that in the long term, crop diversification and resulting higher rural incomes prompted growth in non-farm occupations, often due to a growing demand for retail trade and services .But the hypothesis that production and consumption linkages with the agriculture sector have driven nonfarm job growth in the past two decades is supported by little empirical evidence. Studies show that the non-farm sector (particularly self-employment) acts as a safety net especially in regions of declining agricultural productivity.

An alternative view is that non-farm activity acts as a residual sector so that rural workers who are not fully absorbed in agriculture spill over into non-farm activities. A

variation of this view is that agrarian distress ‘pushes’ rural households to diversify into non-farm activities to mitigate risk from agriculture. This view dominated the debate during much of the 1990s and 2000s, especially since it was observed that crises brought out several household members, women, and the elderly to work who were otherwise not participating in the labour market, and who subsequently withdrew when conditions began to improve. Some recent empirical evidence suggest that non-farm work is to supplement family income rather than to mitigate risk.

Since the 1990s, ‘pull’ factors, in particular, urbanization, have been identified as stimulating non-farm growth. Recent evidence suggests that non-farm employment grew faster in villages close to growing small towns.

2.8 Rural Credit and Microfinance

Credit market failures have been identified as a cause of poverty and a reason why it can be costly to overall economic performance. On the top of long-standing moral arguments, transfer to poor people can be interrelated as a means of relieving the constraints stemming from such market failure. There is another option, namely the policies that make financial institutions for saving and borrowing work better for poor men and women, who cannot meet the collateral requirements. Such policies can matter for protection, by facilitating income and consumption smoothing.

Microfinance programmes aiming to support small-scale credit and saving transactions by poor people has attracted much interest since the idea emerged in the late 1970s, and there are now many examples in the developing world. The instruments that emerged tend to be better suited to supporting small non-farm business development, rather than farming. This is because repayments start as soon as the loan is received, whereas a farmer must wait until after the harvest when rural credit is taken for agricultural inputs. In this way, the microfinance allows the poor people to invest and it gives them new freedom and they eventually escape poverty by their own means. Credit and savings are also potentially important instruments for protection by allowing poor households to more efficiently smooth their consumption in the face of income fluctuations. The Bangladesh group – based lending scheme called *Grameen Bank* has made a conscious effort to reach the poor both through their eligibility criteria and their branch location decisions, which (in contrast to traditional banks) have favored areas where there are

unexploited opportunities for poor people to switch to non-farm activities. The success of *Grameen Bank* has led to a proliferation of microfinance schemes in Bangladesh, with over 5000 providers., and the idea has spread to many other countries. Women have often been favoured by these schemes.

Identifying credit-market failures as one cause of poverty does not imply that credit for the poor will solve the problems. But a well-designed programme has a role,

2.8.1 Why Doesn't Microfinance Work?

Microfinance refers to as provision of small scale financial services for both credits and deposits that are provided to people who farm or fish or herd, operate small or micro enterprises where goods are produced, recycled, repaired, or traded and which provide other services in developing countries in both rural and urban areas. NABARD defines it as "provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or, for enabling them to raise their income levels and improve living standards.'

Microfinance, as an instrument of doorstep financial services, is considered as a well-designed institutional innovation to ensure a substantial flow of credit to collateral poor households and at the same time, it is seen as an important component of financial inclusion. It has been claimed that microfinance could transform the lives of the poor— by raising income and reducing poverty— through its innovative methods of small-loan provision. However, microfinance programme is not a panacea to alleviate poverty from grass root level; rather it is considered only as a means to address the problem. Microfinance interventions expand the access to resources, increase self-employment opportunities and thereby, reduce poverty, provided a proper government initiatives are taken in the direction of social mobilization, capital formation, capacity building and pro-poor programme design. Without an effective intervention in a pro-poor macro policy environment, no such micro policy intervention can be successful in alleviating poverty. Many scholars have been hesitant to claim conclusively that microfinance can significantly reduce income poverty. According to these scholars, at best, microfinance can act as a weak survival strategy for the poor by contributing to the reduction of poverty. Many critics also show that micro finance does not reach the poorest of the poor or that the poorest are deliberately excluded from micro finance programmes.

Even the public banking network in the provision of microfinance through self-help groups (SHGs) or The SHG- Bank Linkage Programme has a number of weaknesses:

(a) Microfinance has continued to form only a small part of the total lending portfolio of public banks.

(b) A major limitation of the programme has been its inability to bring down the average interest rates at which small loans are provided. Resultantly, the rise in households incomes of beneficiaries due to microfinance has been marginal.

(c) NABARD itself has noted a number of infirmities in the day-to-day functioning of SHGs, which might threaten the long term sustainability of the programme. According to Harsh Kumar Bhanwala (2014):

The Increasing outreach of the microfinance programmes has brought in its own challenges. For example, the short-term goals of increasing the number of SHGs at ' any cost' has short-circuited the core principles of SHG financing called 'Pancha Sutra,' namely regularity of meeting, savings, inter-loaning, repayment of credit and book keeping. Further, the trust on providing large multiples of loans irrespective of maturity level of SHGs has accentuated the problem for SHGs.

(d) Last of all, the destructive role of local neo–liberalism hinders the success of microfinance working. That is why microfinance does not work properly. Microfinance does not directly address some structural problems facing Indian society and the economy. Balanced human development is necessary for proper working of SHGs but where human development is low and self-centered individualism is stronger under the impulse of liberalization, globalization and privatization, it cannot work. So, Self-Help Group for Microfinance and capitalist development cannot go hand-to-hand. Hence, it is doubtful whether microfinance in this era will succeed ultimately.

2.8.2 Factors to Future Success of Microfinance

Microfinance programmes in Asia and Pacific countries are found to be successful in extending the services to the poorest sections of the population. Nearly 62 percent

of the members covered under such programmes are poor women in this continent. Historically, Bangladesh dominates among the countries of South Asia in terms of microfinance outreach and share of total borrowers. The Grameen Bank of Bangladesh is a well known people's institution for the poor women promoting small scale production by extending microcredit. Taking the lessons from Bangladesh, micro finance programme has been emerging in a big way in other countries of South Asia. In particular, Sri Lanka and Nepal has achieved a considerable success recently in expanding the outreach of micro finance institutions to promote socio-economic development of the poor households.

The above happenings indicate that microfinance intervention expand the access to resources, increase self-employment opportunities and thereby, reduce poverty, provided a proper government initiatives are taken in the direction of social mobilization, capital formation, capacity building and pro-poor programme design.

2.9 Conclusion

The agrarian economy remains central to rural livelihoods. But rising costs, shrinking farm sizes and stagnating productivity put it at risk, particularly for small and marginal farmers for whom access to land, credit and markets remains challenging. Other interventions include improving access to credit, developing products suited to agrarian livelihoods, and increasing financial literacy etc.

Non-farm sources of income have grown in importance over the last two decades. But non-farm jobs overwhelmingly are in the form of casual labour or daily wage work. Although such jobs do provide the unskilled certain opportunities, they offer no job security, advancement opportunities or other benefits of formal employment. As India is still struggling to move rural workers away from agriculture, it becomes necessary to make rural non-farm activities lucrative enough to attract the growing rural workforce. Analyzing the barriers of entry into this sector employment and also the different activities undertaken in each state or region plays an important role in evaluating the quantum of employment in the rural non-farm sector.

On the other hand , in order to improve and sustain rural economy, proper working, judicious operation and prudent policy for microfinance is urgently called for, preventing the destructive role of local neo-liberalism.

2.10 Summary

Aajeevika: Aajeevika is envisioned as the centrepiece in the fight against rural poverty(it replaced the Swarnajayanti Gram Swarozgar Yojana (SGSY), the then the primary programme aimed at assisting the rural poor in developing alternate income sources since 1999). Aajeevika is based on the core belief that the poor have innate capacities that can be developed through a group approach (collectives such as SHGs, farmer cooperatives and artisan groups) and supported with skills training, marketing knowledge and finance to build sustainable farm and non-farm livelihoods. Aajeevika has a three pillared approach:

- Improving the poor's existing livelihood options;
- Building marketable skills; and
- Nurturing the self-employed and entrepreneurs (for micro enterprises).

Credit-Labour Interlinkage : The credit labour interlinkage is that, in which a landlord employer provides a loan to a peasant in the slack season as part of a contract that entails the latter working for him at a discount in the peak season is presented. This contract enables the landlord to extract the entire consumer surplus even though the effective interest rate charged is the landlord's opportunity cost of credit. The landlord finds an interlinked credit-labour contract profitable when the consumption – loan given to the worker increases its productivity.

Information Asymmetry: The Nobel Laureate George Akerlof introduced the term information asymmetry in his 1970 article, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism." Information asymmetry is an imbalance between two negotiating parties in their knowledge of relevant factors and details. Typically, that imbalance means that the side with more information enjoys a competitive advantage over the other party. Asymmetric information, also known as "information failure," occurs when one party to an economic transaction possesses greater material knowledge than the other party. This typically manifests when the seller of a good and service of possesses greater knowledge than the buyer; however, the reverse dynamic is also possible. Almost all economic transactions involve information asymmetries.

2.11 Exercises

A. Short-answer type questions

1. What is Aajeevika?
2. What is credit -labour Interlinkage?
3. What is Pancha Sutra?
4. What is information asymmetry?

B. Medium-answer type questions

1. What is rural credit? Mention different types of rural credit.
2. What ails the traditional rural industries?
3. What kind of linkages has been operating between agriculture and industry?
4. How does rural industrialization play a pivotal role in the economic development of a country?

C. Long-answer type questions

1. 'The Government of India has introduced a large number of schemes over the years to diversify the rural population into non-farm activities'. Briefly mention few schemes.
2. "The SHG- Bank Linkage Programme has a number of weaknesses". Do you agree? Give arguments.
3. Do you think that the microfinance does not work due to the destructive role of local neo-liberalism ? Explain. What are the future prospects for success of microfinance ?

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Unit 3 ❑ Open Economy Development Issues

Structure

3.1 Objectives

3.2 Introduction

3.3 Terms of Trade and Dependence

3.4 Unequal Exchange

3.5 FDI

3.6 Transfer of Technology

3.7 Role of the World Bank

3.8 Globalization and Development

3.9 Conclusion

3.10 Summary

3.11 Exercises

3.12 References

3.1 Objectives

After reading this unit, you will be able to:

- Understand terms of trade and dependency theory as advanced, to some extent, on the Marxian line;
- Explore unequal exchange as exploitation – a fundamental aspect of the contemporary capitalist global economy;
- Have some idea about FDI and its role in the contemporary world;
- Know about transfer of technology and its advantages;
- Recognize the role of the World Bank ;and
- Know about the hotly debated issue of globalization and development.

3.2 Introduction

"Ideas for development" are fundamental to the future progress of development" especially in the countries in question that engage themselves in international trade. And here emerges the interdependence between nation states through trade flows, international commodity prices and global capital flows. But there is no doubt, open economies are much affected by fluctuations in world trade. How much a country is open is measured by its degree of openness, that is, by the percentage value of the sum of exports plus imports as a share of national products, or GDP: for the most open economies this can be over 60%. But openness has other dimensions. These dimensions revolving over time are being revealed here.

3.3 Terms of Trade and Dependence

Free trade leads to an equalization of factor prices across countries and gains within countries rise most rapidly for the owners of abundant resources as advocated by Ohlin (1935) and others.

A deeper challenge to the above model emerged in the 1950s, hand in hand with development economics. To begin with, several studies pointed to the low elasticity of demand for raw materials. Among the most influential of these studies was R. Prebisch's *The Economic Development of Latin America and Its Principal Problems* in 1950. In this work Prebisch argued that deterioration in the **terms of trade** (ToT) for raw materials in peripheral nations was shaped in part by differences in the relative income elasticities of manufactured and unprocessed goods (with demand for manufacturing goods rising faster than raw material). The argument that the gains from trade are not equally distributed between the centre and peripheral countries came to be known as the "Prebisch- Singer Thesis."

A complementary line of analysis emphasized that Less Developed Countries (LDCs) were characterized by low-level equilibria that prevented growth. Some studies focused on the "circular relationships that affect both the demand and supply side of the problem of capital formation in economically backward areas" (*Nurkse 1952:571*). Others focused on the dynamics of labour supplies and a capitalist investments in a situation of economic dualism between capitalist and subsistence sector (*Lewis 1954*). Most of

these studies sought to identify mechanisms to promote faster industrial growth, although debating continued whether the balanced or unbalanced growth was required to break from low-level equilibria.

The notion that the social structure of LDCs differed from that of more developed countries is important. Thus Raul Prebisch emphasized the unequal advantage derived by centre and peripheral nations from their world economic linkages, resulting in a long-run improvement of the ToT of centre, but a deterioration of these terms for the periphery.

But every doctrine coincided in emphasizing the role of industrialization as the key mechanism for breaking away from low-level equilibria.

Radical Challenge to Comparative Advantage

A more radical challenge to the notion of comparative advantage came from the literature that came to be known as **dependency theory.** Some authors sought to broaden the scope of Prebisch's analysis, emphasizing that it was in the very nature of capitalist development to produce the underdevelopment of peripheral countries. In this context Andre Gunder Frank' s concept of 'development of underdevelopment' is the result of being involved in the world- economy as a peripheral, raw material area, as Frank puts it for Chile, ' underdevelopment… is the necessary product of four centuries capitalism itself". Andre Gunder Frank (1967) critiqued that modernization theories of development failed to focus on the exploitative character of the relationship between metropoles and satellites. Organized through a chain, reaching from the largest wealthiest cities of the world to the poorest rural areas and small villages, Frank argued that this relationship served to transfer economic surplus from satellites to metropoles, thereby "under developing" the satellite by draining their wealth. For Frank the underdevelopment would be most pronounced among satellites.

Dependency theorists viewed the global system as one in which uneven development made rich nations forge ahead while LDCs stagnated. The mechanisms cited included patterns of specialization in which rich countries specialized in technology-intensive sectors while LDCs specializing in primary goods and simple manufactured goods, were denied major technical change. Moreover, flows of foreign capital from rich to poor countries (especially through MNCs)were seen as ultimately resulting massive economic surplus transferred from poor to rich regions. This adversely affected domestic capital formation and enterprise.

Along these lines, Emmanuel (1969) developed the argument that the deterioration in the ToT for the product of peripheral countries was likely to take place even under conditions of perfect competition. In this model, the perfect mobility of capital ensures equal profit rates between the core and peripheral countries, but the restrictions upon the mobility of labour results in persistent wage-rate differences between these countries. Under these conditions, the exchange of products between core and peripheral countries entails an exchange of unequal values, or **unequal exchange** and hence a transfer of surplus from peripheral to core countries.

Emanuel's model has been criticized on several fronts, including its treatment of wages as an *exogenous* variable, and for failing to consider potential differences in level of productivity between core and peripheral labour.

A **modified interpretation of unequal exchange** was provided by Amin (1970), who sought to make wage levels in core and peripheral countries *endogenous* in his model, and argued that the function of unequal exchange is to allow capital in core countries to escape a squeeze on profits. Within WORLD SYSTEMS ANALYSIS, there has been a growing emphasis on the uneven spatial distribution of innovation and competitive pressures as a determinant of differences in the gains from trade among core, semi-peripheral and peripheral countries.

Since the 1970s, there has been a resurgence of a new classical emphasis on comparative advantage as a basis for organizing world production and trade.

Recent post-Keynesian approaches are different. For example, Prasch (1996) emphasizes the need to develop a realistic theory of trade based on political economy foundations. He tries to eschew the problematic assumptions of many neoclassical models of comparative advantage. These include no externalities, free and costless mobility of capital and labour, full employment of available resources, balanced trade etc. Instead he suggests that an alternative theory of trade should place greater emphasis on the environmental problems associated with trade etc, incorporating historical time into the analysis (including path dependency and dynamic comparative advantage).

Norman took a similar position, but went further by incorporating more realistic assumptions unto his model. Attempting to develop a post-Keynesian theory of protection, he based his model on the "normal situation" of underutilized resources (including labour), two sectors of oligopoly(for finished goods with mark-up pricing) and competition(for primary industry with supply and demand pricing).In this system, he found that the introduction of a differential tariff on goods produced marked increases in output but

small increases in prices. Such was the outcomes of more realistic theory incorporating an oligopoly sector, Keynesian macro-policy and the importance of non- price competition for finished goods.

3.4 Unequal Exchange

Exploitation is a fundamental aspect of the contemporary capitalist global economy. It is the basis by which the core economies, and rich elite classes, both maintain their position of dominance. The theorists emphasize the negative factors associated with an international trading system whereby one party to an exchange benefits a great deal more than the other. This can be represented in many sectors across the global economy.

Many examples of unequal exchange have their roots in imperial history. One dimension of inequality is the disadvantages faced by the exporters of agricultural produce from the developing world when many developed states, notably those in the EU (European Union), create an unfair advantage for their farmers by heavily subsidizing this sector.

Thus, this indicates that this is one type of blocked development phenomenon. Here the economic development is deliberately impeded by developed countries. It has been asserted that dominant countries of the world have blocked the development of Third World countries, permitting them only 'peripheral capitalism'.

To focus this in more detail we can tell that the liberal theory of free trade based mainly on the theory of comparative advantage is regarded as a win-win situation without any limitations. During the 1950s, however, development theorists presented a challenge to this well-established neoclassical theory. The theory of *unequal exchange* is a reaction to the naïve theory of comparative advantage. It provides a Marxist notion of the exploitation that is embedded in the comparative advantage theory.

The development of the theory of unequal exchange has followed several directions. First, some writers, including Andre Gunder Frank in *Capitalism and Underdevelopment in Latin America (1967),* argued that comparative advantage is not a natural endowment; rather, it is created by historical power relations through the exploitation of nations.

Second, some researchers examined the distributional inequalities of trade. Thus, the Prebisch-Singer thesis reveals that the terms of trade work against developing countries. This well-known issue of dependency theory was systematically developed in the 1950s.

Third, on the basis of assumptions of the restricted mobility of labor and the perfect mobility of capital, Arghiri Emmanuel (1969) formally developed the theory of unequal exchange. He argued that under a situation of perfect competition, trade between developed and developing countries involve a transfer of surplus from the latter countries. In a situation of equal productivity in developed countries (DCs) and less developed countries (LDCs), but lower wages in the LDCs, high-priced products of the DCs are exchanged for low-priced products of the LDCs. Hence, the exchange is unequal. Emmanuel noted that since wages are institutionally determined, they are exogenous to the model. However, in DCs, trade unions have a critical role in raising wages. But this is not the case in LDCs. In the process of unequal exchange, there is a transfer of value from a country with low capital intensity (often a developing country) to a country with high capital intensity in production (as in a typical developed country).

A. Emmanuel, the Greek-French Marxist, has used the Marxian theory of transformation of value into prices to show that LDCs are compelled to sell their goods at prices below their values and to purchase goods from DCs at prices above their values. In the process, the advanced countries appropriate more labor time than they generate in production. In other words, DCs can get commodities from LDCs at lower prices than would have been available in their own countries. In this process of exchange, LDCs stand as losers, and DCs as gainers.

Emmanuel's analysis has been subjected to severe criticism by many scholars, including Paul Samuelson, who tried to demonstrate that the argument developed by Emmanuel is preposterous. According to Samuelson, Emmanuel concentrated simply on the circulation sphere and failed to recognize the productivity differentials between core and peripheral countries. Emmanuel is also criticized on the grounds that he treated wages as an exogenous variable.

Samir Amin (1970) presented a new version of unequal exchange by considering wages as an endogenous variable, and he showed that unequal exchange allowed capitalist countries to protect profits. To him, the dominance of foreign capital in LDCs means distorted export activity and the hypertrophy of the tertiary sector. Peripheral countries thus incur heavy debts to core countries, become necessarily dependent on them, and become linked with the world capitalist system.

In the new world order, trade is organized largely by powerful multinational companies without any regard for small peasants and poor workers. The social cost of trade in terms of damage to the environment and human rights is much greater in LDCs.

Even in a situation of trade based on comparative advantage, the gains from trade are not equally distributed. Because of the many structural differences between the LDCs and the DCs, factor price equalization is not possible. Domestic wages are falling in LDCs due to the *race to the bottom* and the informalization of labor markets. The advantage of productivity gains through higher wages has never trickled down to LDCs through the channel of trade. Unequal competition and dissimilar bargaining powers between these two groups of countries make the theory of unequal exchange still relevant.

3.5 FDI

Foreign direct investment (FDI) is long term capital movement of a particular type. (Capital movement does not imply physical movement of machines and equipment. It refers to movement of investible funds or finance). If the lender, that is, purchaser of the productive asset, has operating control over the asset's use then investment is direct, otherwise it is portfolio. One can acquire control by buying enough shares of common stock in a company.

FDI is distinct from other capital flows (portfolio equity investment, bond finance, and commercial bank lending, as well as aid and remittances) in that it primarily reflects managerial rather than portfolio behaviour.

Under the right conditions, FDI can generate direct and indirect increases in employment, promote competition, improve the training of host-country workers, and transfer technology from developed to developing countries. It may also subject workers to unsafe working conditions, compromise the natural environment, and increase the dominance of foreign culture over host country cultures.

Foreign direct investment can contribute to poverty alleviation when it supports the generation of new employment, improves the education and training of host-country workers. These benefits are evident in a host of developing countries.

Foreign direct investment can have positive effects on poverty by creating employment, improving technology and human capital, and promoting competition. While much of FDI contributes in this way, at times it may adversely affect certain dimensions of poverty through unsafe working conditions and environmental destruction.

Many countries encourage inward FDI because they expect that the foreign firms will enable domestic enterprises to become technologically more advanced. .In fact FDI is a vehicle through which developing country firms learn about new technology.

FDI has grown spectacularly since 1945. Although the bulk of it has taken place within the capital-abundant industrialized world, the pattern is beginning to change with the rapid economic growth in the countries of South and East Asia. Most developing countries have long accepted that FDI offers a potentially significant source of financing because, in addition to being a relatively stable source of capital, it can bring with it up-to-date technology, organizational skills and distribution networks, with possible spillover effects. China, since opening of its economy to the outside world in late 1978, has absorbed an increasing amount of FDI and now among the world's largest hosts of FDI inflows. It is found by empirical findings that firms that receive FDI (joint ventures) or are acquired by multinationals generally exhibit not only higher productivity levels,but also higher productivity growth

Most countries encourage FDI inflows in specific sector which are technologically advanced. Attracting FDI has been an important strategy in technology adaptation in a number of cases. It was also found that public sector enterprises in Indonesia has improved their performance after forming joint ventures with foreign enterprises. Using several firm- level data for several Latin American countries researchers find that multinationals indeed lead to an increase in the varieties of inputs in Latin American countries acting as host countries

The Role of FDI

If we consider recent trends in capital flows, aid, and remittances for developing countries, a number of important characteristics become visible. Since the early 1990s, FDI has emerged as the most important foreign resource flow for the developing world as a whole, surpassing foreign aid or official development assistance (ODA) by increasing amounts. While a downward trend in FDI has recently appeared, the long-term growth and volume of these flows has been remarkable, inspiring much comment on the possibility of private capital replacing aid. Recent data suggest a recovery of FDI inflows.

FDI refers to capital inflows from abroad that are invested in or to enhance the production capacity of the economy. FDI and economic growth has long been a subject of great interest in the field of international growth. In the era of volatile flows of global capital, the stability of FDI emerges as an effective channel to faster growth in developing countries. It plays an important role in the long-term development of a country not only as a source of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and

generating new employment opportunities. In India, FDI is considered as a developmental tool, which helps in achieving self-reliance in various sectors and in overall development of the economy. India after liberalizing and globalizing the economy to the outside world in 1991, there was a massive increase in the flow of foreign direct investment. Foreign Direct Investment (FDI) is often seen as important catalysts for economic growth in the developing countries like India. FDI affects the economic growth by stimulating domestic investment, increasing human capital formation and by facilitating the technology transfer in the host countries.

Trends in FDI

Since the early 1980s, FDI has grown at a much faster rate than both output and trade, in part facilitated by changes in manufacturing production processes and in financial corporate governance, development in equity markets, increased liberalization of FDI regimes and privatization, among other factors. As a consequence of the rapid growth in flows, the stock of world FDI has increased almost 20-fold since the early 1980s, reaching close to a quarter of world GDP. Yet the flows have remained concentrated in the developed countries. Meanwhile, the developing countries had experienced a 10-fold increase in average annual inflows from the first half of the 1980s to the second half of the 1990s. FDI flows have been concentrated among handful of countries. China's share of FDI increased from 1.1 % of the global FDI inward stock in 1990 to over 6% in the late 1990s.

The sectoral composition of FDI stocks has changed in both the developing and developed countries. Among the developed countries, inward FDI flows have been increasingly directed towards services. Between 1990 and 2004, the share of manufacturing in the FDI stock of the group of developing countries rose from 25% to 37%.

Sectoral trends of FDI differ among developing countries and regions. Since the late 1980s, Latin America and the Caribbean have attracted FDI in large-scale natural resources and services through privatization, also in textiles and clothing. Africa has attracted FDI mainly in fuel and minerals. South African countries have been able to attract FDI in manufacturing as well as in textiles and garments. East Asia and South-East Asia have attracted FDI in manufacturing. In this respect, we can say that economic divergences occur.

Concentration and Divergence in FDI flows

Since the early 1980s, several new trends have emerged, introducing new challenges and opportunities. First, there have been significant changes in the way governments interact with transnational corporations owing to a rapid and widespread liberalization of FDI policy not only in developed countries but also in developing countries.

Second, large corporations have introduced new practices in respect of the way they mange their assets abroad. Third, there arises in corporate strategy a bend towards mergers and acquisitions as opposed to Greenfield investments. As a result, the recent rapid expansion of export-oriented manufacturing activities linked to FDI has been heavily biased towards a handful of countries of developing world.

Can FDI Lead to Faster Growth in Developing Countries?

The answer is that, the flows of FDI are a force for convergence between industrialized and developing countries, or even among developing countries. By the early 1990s, following a decade of or more of macroeconomic adjustments and microeconomic reforms, it was believed that resurgent FDI flows were a sign of improvement in the investment climate in many developing countries. Moreover it was anticipated that FDI and domestic capital formation will be moving in same direction. But since the early 1990s, the opposite happened. It was found that as FDI flows increased, investment rates and volumes declined or stagnated in the major developed and developing economies. For instance, when measured as a share of GDP, FDI rose while overall investment stagnated or fell in major Latin American countries, and in some larger African countries (Morocco, South Africa and Tunisia). It is possible that the conditions that attract foreign enterprises may not be conducive to faster capital formation in the host ecoonomy.

The impact of FDI on the balance of payments (BOP) of the host country very considerably with the sectoral pattern of FDI inflows, the share of transnational corporation profits in value added, the degree of import dependence. Thus the danger is that as remittances and other capital outflows linked to FDI begin to accrue, the long-term impact on BOP will be negative.

In order to proofit from FDI, the countries need to have the necessary absorptive capacity among domestic firms and institutions. If this is there, then the countries will be that most successful in leveraging inward FDI. Example, Singapore and Ireland. It therefore appears that the FDI has been a great force as much for global divergence as for convergence.

3.6 Transfer of Technology

Technology Transfer, also called Transfer of Technology and Technology Commercialization, is the process of transferring skills, knowledge, technologies, methods of manufacturing, samples of manufacturing and facilities among governments or universities and other institutions to ensure that scientific and technological developments are accessible to a wider range of users who can then further develop and exploit the technology into new products, processes, applications, materials or services. It is closely related to knowledge transfer. Some also consider technology transfer as a process of moving promising research topics into a level of maturity ready for bulk manufacturing or production.

It is noteworthy in this connection, that China's technology strategy has been to allow foreign firms access to domestic market in exchange for technology transfer through joint production or joint ventures. Wholly-owned foreign firms are a rarity in China. Most firms are joint ventures between local (frequently state-owned) and foreign enterprises.

Why technology transfer?

Most of the Transfer of Technology takes place because some organizations in which technology is maintained or developed may be different from those who bring the technology into the market. It is considered as a Commercialization.

Objectives of Technology Transfer

The main objective of Transfer of Technology is to make Technologies and Product available for use by everyone. It also contributes to the economic development of Organization, Nations and region. By this Commercialization takes Place. **Transfer of Technologies** makes the technology more improved and cheaper.

Advantages of Technology Transfer

Transfer of Technology is increasing day by day and it is also important for commercial enterprises to gain some advantages from their competitors. Some advantages of Technology Transfer are:

- It leads to competitive advantage for a company from its competitors
- It helps in research and development of a product. Transfer of technology helps organizations to modify it according to needs.
- Transfer of Technology makes Technology new, and new innovations lead to the creation of a new market and demand.
- It helps in the commercialization of technology.

3.7 Role of the World Bank

This is an international organization established in 1947 as the International Bank for Reconstruction and Development (IBRD), following the Bretton Woods Conference,1944, to provide economic aid to members.

Following the Second World War the International Bank for Reconstruction and Development (IBRD), now known as the World Bank, (an international financial institution owned by its 189 member countries and based in Washington, D.C.) was established to revive and reconstruct the war-torn European economies. And from the 1960s onward this mandate was later extended to all developing states/ emerging economies and, after the collapse of communism, transition countries. However, following the appointment in 1968 of Robert McNamara, a former US secretary of Defence, as president of the World Bank, its priorities shifted towards projects dealing with basic needs.

The World Bank operates with borrowed funds. The Bank raises its funds through borrowing from international markets and by dues from member states. Its main objective is to provide development funds to developing nations in the form of interest-bearing loans and technical assistance. The loans made by the Bank to developing states are

given at a lower interest rate than commercial banks and are aimed at supporting the construction of infrastructure projects (roads, power plants, hydroelectricity dams and so on) with a growing emphasis on the task of reducing poverty. Similar to the IMF, the World Bank has also been a staunch supporter of the 'Washington Consensus'. Both organizations were created by the Bretton Woods agreement of 1944, with its first loan ($250 million to France for post-war reconstruction), are housed in the same building in Washington D.C.

The Bank supplies not only foreign exchanges to finance development projects, but also provides expert personnel and promote 'technology transfer' from advanced countries to the developing countries as a means of upgrading their economic capabilities.

In addition, the World Bank is the major collector and dissemination of information about development, its publications including the World Bank Annual Report, the World Development Report, The World Bank's Ease of Doing Business Report and the review Global Development Finance. Critics of the World Bank have argued that its function of development is insufficient, that its record of reducing poverty is poor, that its neoliberal bias remains in place despite the abandonment of the Structural adjustment programmes (SAPs), and that, together with the WTO and the IMF; it tends to uphold the imbalances and disparities of the global order rather than challenge them.

3.8 Globalization and Development

Just thirty-eight years ago, the term ' globalization' was a relatively unknown concept. For some, globalization refers to a set of processes which involve the increasing multidimensional flows of things, people and information across the planet.

Globalization has become a hotly debated topic now. David Held and his colleagues (1999) divided the arguments into three broad schools: hyperglobalizers, sceptics and transformationalists. These three tendencies are summarized in Table 3.1

Table 3.1: Conceptualizing globalization: Three tendencies

	Hyperglobalizers	**Sceptics**	**Transformationalists**
What is new?	A global age	Trading blocs, weaker geo-governance than in earlier periods	Historically unprecedented levels of global interconnectedness
Dominant Features?	Global capitalism, global governance, global civic society	World less interdependent than in the1890s	"thik' (intensive and extensive) globalization
Power of national governments?	Declining or eroding	Reinforced or enhanced	Reconstituted, Restructured
Driving forces of globalization?	Capitalism and technology	Governments and markets	Combined forces of modernity
Summary argument	The end of the nation-state	Internationalization depends on government acquiescence and support	Globalization transforming government power and world politics

Source: Adapted from Held et al. (1999:10)

Hyperglobalizers

Hyperglobalizers see globalization as a very real, ongoing process with wide –ranging consequences. Globalization is producing a new global order, swept along by powerful flows of cross-border trade and production. Kenichi Ohmae sees globalization leading to a 'borderless world' in which market forces are more powerful than national governments. A large part of the idea rests on the idea that nation-states are losing the power to control their own destiny. Governments are increasingly unable to exercise authority over cross-border volatile financial markets, investment decisions, increasing migration, environmental dangers or terrorist networks. Citizens also recognize that politicians have limited ability to address these problems and, as a result, lose faith in existing systems of national governance.

Sceptics

Sceptics argue that it may be more accurate to talk of 'internationalization' rather than globalization. And nation-states will continue as central political actors. National

governments will remain as key players because they are involved in regulating and coordinating economic activity, and some are driving through trade agreements and policies of economic liberalization. However, they focus on processes of *regionalization* within the world economy— such as the emergence of financial and trading blocs. They also argue that hyperglobalizers are misreading the historical evidence.

Transformationists

Transformationists take a position somewhere between those of skeptics and hyperglobizers, contending that globalization is breaking down established boundaries between the internal and the external, the international and domestic.

Evaluating the evidence

The transformationists' view fits the present evidence quite well. The 2008 global financial crisis brought home some of the risks inherent in an emerging 'borderless economy'. In the European Union, huge economic bailouts of the Republic of Ireland, Cyprus, Greece and Portugal led to renewed questioning of the single currency and the logic of 'ever closer union'.

Relationship between globalization and development—some aspects

The relationship between globalization and development is contested. For some, globalization is a powerful force for poverty reduction and has led to leaps in life expectancy and other key dimensions of development. For others, globalization has negative implications and is seen as a source of growing inequality, poverty, unemployment, and environmental destruction. Advocates of both perspectives can point to evidence to support their views as in practice the flows that represent globalization can have both positive and negative impacts. The outcome depends on the policies and preparedness of societies to manage the flows to ensure that the positive potential is harvested while the negative consequences are managed and mitigated.

(i) Finance and Development

Global financial flows are an important resource for developing countries. These capital flows augment domestic savings and can contribute to investment, growth, financial

sector development, technological transfer, and poverty reduction. Aside from aid, there are four different types of capital flows. The first is *foreign direct investment*, the second *equity investment,* the third *bond finance and debt issuance* and the fourth *commercial bank lending*. In practice, these may be combined and mixed in various hybrid formulations. In 2019, the total of these private flows to developing countries is estimated to be more than one trillion dollars.

Foreign direct investment involves the acquisition of over 10 per cent of a foreign-based enterprise, which usually implies managerial participation in the foreign business. *Equity* investment involves the purchase of shares in foreign enterprises. Where the shareholding is too small to involve managerial participation, it is termed *equity portfolio investment.* These investments are indirect rather than direct and are undertaken to gain exposure to the foreign firm rather than to exercise managerial control. *Private equity* is a form of investment in which investors buy shares in unlisted companies which are not publicly traded on a stock exchange. If they are listed, the private equity investment leads to a buyout of a publicly listed company and its delisting. Private equity investments are typically made by a private equity firm or very wealthy individual, whereas portfolio investments may be made by large numbers of investors through purchases of listed shares or by mutual funds and financial brokers.

Bond finance is a form of debt issuance that involves governments or firms issuing bonds, which are purchased by investors who loan the issuer money for a defined period of time at a variable or fixed interest rate. Bonds are used by governments, companies, cities, states, and other institutions to raise money and can be issued in either domestic currency or foreign currency. The risks associated with bonds not being repaid are known as **default risks**, and are evaluated by *credit rating agencies.* International investment in bond markets in developing countries requires the establishment of credit ratings for the countries and companies. The number of ratings in these markets has grown rapidly in recent decades from barely a dozen countries to 100 countries. International investors typically require *investment grade* ratings from two agencies. Investment grade is classified as BBB– or higher by Standard & Poor's and by Fitch, and Baa3 or higher by Moodys.

Commercial bank lending is another form of debt, but whereas bonds can be bought and sold, and are therefore tradable assets, bank lending is not tradable. Until the 1990s, commercial bank lending was the principal source of finance for many middle-

income countries and for firms. Subsequently, equity portfolio investment and bond finance flows have become more significant. The volatility of these flows was demonstrated following the Asian financial crisis in 1997 and again during the global financial crisis of 2007-9 and again more recently. From July 2009 until the end of June 2014, a net total of $2.2 trillion in capital flowed into the fifteen largest emerging markets. In subsequent months, changing sentiment and the impact of the tightening of monetary policy in the United States led to a reversal of the flows, with net capital outflows from emerging economies expected to amount to $540 billion in 2015.

Since 2000, the United States Treasury has been by far the biggest issuer of bonds, and owes over $13 trillion, of which over $6 trillion is to foreigners. China holds reserves of over $3 trillion in United States Treasuries. As a result of transactions such as this by the United States, European, and other advanced countries, developing countries have become net exporters of capital.

In recent years, the returns on fixed-income, debt, and bond products have declined in advanced countries. Meanwhile developing countries have become more attractive investment destinations as a result of their improved economic performance and robust growth, relative to the advanced economies. In the first five months of 2015, developing country governments raised a record $210 billion in sovereign bonds, double the level of issuance of the comparable period in 2010. Private companies increasingly have turned to bond markets rather than bank lending to raise finance with firms in developing countries having raised over $2.4 trillion through corporate bonds. Private equity has similarly grown rapidly as a source of finance for many developing countries.

Over the past two decades, private equity has grown rapidly, providing a new source of finance for private investments in developing countries, with cumulative investments exceeding $30 billion in Africa alone.

(ii) Trade and Development

Trade is a key dimension of globalization. The promotion of equitable trade includes improving access to key international markets for developing countries. The opening up of markets through the removal of trade barriers such as tariffs and subsidies has the potential to contribute far more towards development than international aid flows.

Agricultural protectionism takes many forms. Subsidies of around $250 billion per year are given to grain and farmers of other protected agricultural commodities in Europe,

the United States, and Japan. As a result of these subsidies, each day the average Swiss cow benefits from subsidies which are much greater than the daily income of over 300 million Africans. In addition, quotas on the import of certain products, such as North African tomatoes and citrus, as well as tariff and non-tariff barriers, undermine the ability of developing countries to compete in agricultural products in the protected markets. As a result of these measures, the products produced by poor people on average face double the tariffs that producers in rich countries face.

Agricultural protectionism not only impacts negatively on poor people in poor countries but also has a negative impact on people in the richer countries. In the United States and Europe for example, the cost of sugar, dairy products, and cooking oil is well above global market levels, so that the average European pays over 1,000 euros more per year for their food than they need to ($1,000 in the United States). As poor people pay a higher share of their income on these foodstuffs than rich people, these subsidies have a regressive social impact, and increase inequality in rich countries, as well as between rich and poor countries and within poor countries.

Achieving a more even playing field is a central objective of the Doha Round of Trade Negotiations that was initiated in 2001. The apparently insurmountable obstacles to the completion of the Trade Round have meant that trade barriers continue to undermine the development agenda. Protectionism also serves as a drag on global growth.

While in the advanced economies agricultural protectionism is often justified as helping small farmers—thereby improving food security for poor people and protecting the countryside—in reality the opposite is the case. In Europe and the United States over 80 per cent of the benefits of agricultural protection go to under 5 per cent of farmers, with small numbers of well-placed farmers earning millions of euros or dollars a year from taxpayers and consumers. As these subsidies contribute to higher land values, agricultural protectionism serves to increase the intensity of land use, and encourage excessive application of fertilizers and pesticides. Protectionism in the United States and Europe has led to a concentration of land ownership, as it mainly funds large farmers. The small farmers who produce crops that are not subsidized find that they are increasingly uncompetitive.

Trade in knowledge and ideas are another important area for reform, with Trade Related Intellectual Property Rights (TRIPs) becoming more important to developing countries. It is often argued that intellectual property rights drive innovation and contribute to growth by creating incentives to pursue new ideas. The problem for developing countries is that intellectual property rights are a legally sanctioned restraint of trade. They can lead to the monopolization of ideas and innovation by first comers. Developing countries fear that countries with better endowed research and legal systems will prevent affordable access to technologies which are crucial for development.

(iii) Technology and Development

The relationship between development and technological progress is complex. Technological progress embodies new ideas and is bundled with an often wide range of skill, process, infrastructure, cultural, and other changes. No technology is a panacea and the adoption, adaptation, and dissemination of technological changes need to be seen within wider institutional, economic, and social settings.

The adoption of new technologies is a key dimension of development. So too is the adaptation and modification of technologies to meet local needs and be applicable for use within particular societies.

The world has witnessed the rapid pace of scientific invention, with advances in computing, nano medicine, stem cell research, genetics, artificial intelligence, robotics, and computing all pointing to the potential for science to address critical challenges. Optimists point to the potential of these and many other technologies to meet the needs of development. Others worry about the potential for the accelerating pace of change to leave many poor countries and poor people further and further behind. Even in the rich countries, they may well widen inequality, with those that fail to effectively adopt or adapt to technological change finding they are replaced by machine intelligence and robots which perform a widening range of tasks. There is a real risk that technological change may exacerbate inequality as large groups of individuals may be disconnected due to illiteracy or absence of broadband, find that they are unemployed and that their skills are no longer relevant, or become otherwise excluded from the benefits of change.

(iv) International Regulation and Cooperation

The prevention of transfer pricing and of tax avoidance is important in building a sound revenue base for development. Transfer pricing—or mispricing—involves

manipulating the prices charged for goods and services sold between subsidiaries controlled by the same company. By charging high prices, multinationals can move profits out of one country and into another in order to take advantage of low or zero tax havens. Large corporations have also taken advantage of a complex range of other tax avoidance initiatives including loopholes, tax shelters, and financial arrangements (such as artificially high interest rate payments to controlled entities) in order to minimize their tax bills.

While corporations and financial flows are increasingly globalized, governments are constrained to operate within national jurisdictions. We can cite one example. Several major global companies 8 years back were publicly criticized for not paying their fair share of tax. Amongst those were Apple, Google who has avoided a tax bill of $2 billion in 2011, and Amazon, which paid no corporation tax in the U.K. on income of £ 3.3 billion. Tax avoidance is especially costly for low-income countries, which are in urgent need of financial revenues but lack the resources for effective tax enforcement. Actions which follow from this information may require legal reform or treaty changes. However, even when such treaties are signed, they are not implemented by national governments. Indeed , countries find it much easier to sign agreements than to implement nationally.

It has been argued that the more globalization encourages flows of finance and trade, the more illicit commerce— estimated as around 10% of all flows— also flourishes. Among the flows we find small arms, toxic waste, slave and sex trafficking, ivory and other illicit trade. Not all trade is beneficial, and control over harmful illicit trade is a necessary dimension of cooperation to ensure globalization helps— not hinders— the achievements of development objectives.

Globalization and Development : A Debated Issue

Globalization is a powerful force and is an engine of risk creation. It can promote growth but also large inequalities and poverty. it can lead to achievement but also frustration. Globalization can lead to turbulent financial markets and capital flows. it disrupts and undermines traditional economies. It can destroy traditional society structures, and lead more protests and instability. It can lead to growing unemployment and debt. With globalization, non-state actors (such as MNCs) have grown in power. Foreign aid has disappeared while the prices for global commodities produced in the developing world have decreased. Developing countries are more integrated into the world trading system, based on the share of exports in GDP.

There is no shortage of studies that have examined that relationship between globalization and development. But most studies have focused on the relationship between globalization and economic growth.

Supporters of globalization argue that trade liberalization policies encourage exports, which directly contribute to GDP growth. More openness will also lead to increased levels of FDI, which than raises and productive capacity of developing countries and helps transfer knowledge and expertise. Financial liberalization will also make new technology more assessible, encourage the development of the domestic financial market and assist with providing domestic credit.

Intense debate has taken place analyzing the relationship between globalization and inequality. Some scholars like Stiglitz, Birdsall and Talbot have domonstrated that there are links between globalization and inequality. Both Amartya Sen and Martin Ravallion note that globalization brings rising disparties in standard of livings *within* coountries. Empirical evidence has shown that trade openness has contributed to *intra-country* inequality. For example, China has lifted 400 million people out of poverty but the progress on poverty reduction has been uneven. Globalization may laso cause explosive social cleavages as the gaps between rich and poor increase. Globalization may lead to rising expectations and growing frustration when the result of growth is not felt by everyone. B. Milanovic and others show that the effects of openness on income distribution depend on a country's initial income level. Thus, globalization is generally thought to increase inequalities. The case of Chile illustrates two-sided coin of globalization. Globalization there has spurred economic growth, but has also lead to growing inequalities.

Some other studies have pointed out that inequalities are driven more between countries rather than within countries. P. Aghion and J.G. Williamson explore the relationship among globalization, growth and inequality, arguing that inequalities can be explained by surges in trade and technology. S. Seshanna and S., Decornez in 2003 demonstrate that through the world economy has become wealthier and more globalized in the past 40 years, it has also become more unequal and polarized. By the 2000s industrialized countries were producing over 80% of the world's GDP and consuming over 80% of the world's goods. Critics charge that globalization has benefited the most powerful industrialized countries, while developing countries have become more dependent on these powers. Countries that have been unable to take advantage of technological possibilities have been the gaps between the rich and poor accentuated. Jagdish Bhagwati

contends that the barriers erected by the developed world poses the bigger problem in the developing countries.

Additionally, critics find the global concentration and monopolization of economic, political and organizational power in the hands of the few MNCs to be very alarming. Policy choices that emphasize cushioning the blow of globalization are often impaired because power is concentrated in the hands of global corporations. David Koren argues that it is difficult to have equal democratic societies when economic and political power is concentrated in a few large corporations.

Other studies demonstrate the ways in which globalization the poor in developing countries. Almas Heshmati underscores that it is difficult to say that trade openness and financial integration will reduce poverty. Scholars like K. Rogoff and others have argued that it is very to find a direct linkages between financial integration and poverty. Overall, Amartya Sen and Martin Ravallion claim that there is weal evidence that globalization reduces poverty. Extreme poverty rates rose sharply during the period from 1980 to 1999.

Critics have also claimed that globalization has increased the number of urban poor and rural landless. Over 80% of all the lands in developing world is owned by only about 3% of all landowners. Studies in India have demonstrated that the rural poor has gained less from trade reforms than other income groups because they also still face restrictions on labour mobility.

In contrast to these findings, other studies have argued that economic growth is the best anti-poverty measure. Paul Collier and David Dollar and the World bank Development Report have explored the relationship among globalization, growth, and poverty, arguing that globalization reduces poverty because more integrated economies tend to grow faster. Supporters of globalization argue that poverty rates have fallen. However, When China and India are taken out of the equation, decreases in poverty rates are minimal.

Proponents of globalization argue that it reduces poverty because faster transmission of knowledge creates an environment that is more conducive to growth. India has opened up to more FDI, leading to a decline in poverty.

M. Nissanke and E. Thorbecke have pointed out that openness through trade and financial liberalization increases the flow of goods and capital and can contribute to economic growth. Nevertheless, they caution that though it is likely that the poor benefits

from growth, how growth affects poverty reduction depends on the pattern of economic growth, development and income distribution.

Countries in the developing world that are highly integrated and exposed may be more vulnerable to financial crises, which can increase poverty rates. Recent emergence of Corona Virus has pushed the 40 crore Indian people to poverty traps. However, unrestricted capital flows are associated with higher rates of poverty. There is a propensity for high levels of capital flight from developing countries to developed countries during the period of instability and crisis. Joseph Stiglitz echoes this, claiming that capital market liberalization is problematic. World Bank research also showed that this was the case. This research was than later confirmed by the IMF.

Financial crises are particularly hard on the most impoverished' In Indonesis, the poverty rate increased by 50% after the currency crisis in 1997. Real wages declined by 40%. Household consumption fell by 15%.

Globalization may spur growth but this will not reduce poverty on its own. Poverty reduction requires both higher levels of growth and pro-poor distribution of the gains from growth. How gains from growth are distributed is very important to alleviate poverty. Higher growth rates can often lead to income inequality, which can dampen the positive effects of growth on poverty reduction.

Who Benefits from Globalization ?

The answer is they globalization may only alleviate poverty in states that are equipped to benefit from it. Globalization tends to benefit states that already have diverse economies. States in the developing world have smaller and less diverse economies that make them more vulnerable to fluctuations in the economy. States in the developing world must content with the volatility in the price of their primary products and deterioration in the terms of trade. For example, Senegal produced 141,000 tons of groundnuts, which represented up to 80% of its exports in 1960. Several decades later, groundnuts still constituted the principal exports for Senegal but the conditions of farmers deteriorated significantly. Countries in the developing world have difficulty diversifying because they lack market power and a domestic resource base to deal with external shocks.

Globalization also benefits skilled labour more so than unskilled labour. Proponents of globalization argue that globalization will lead to a demand for unskilled labour in developing countries. However, globalization has been blased towards skilled and educated labour, and recent technological improvements have saved costs on labour. Previous

economic theories have postulated that countries with labour abundance can have an advantage. Stolper Samuelson theory claimed that countries with labour abundance should see their incomes increase when they open up to trade. Developing countries would benefit from trade reforms because they have a comparative advantage in unskilled labour. However, most jobs today require more skills than the poor in developing countries possess. Moreover, there has been a race to the bottom with waves–and labour unions have been weakened.

Capital and skilled labour do not tend to migrate to poor countries. It is more likely that skilled labourer from the developing countries will migrate to developed countries, such as the missive migration of skilled health workers from Africa migrating to Europe and the United States. For unskilled workers in developing countries, it has become more difficult to migrate abroad. A. Solimano in 2002 argued that from 1870 to 1914 over 60 million unskilled workers migrated from Europe to North America, whereas today unskilled workers attempting to do the same face many obstacles.

Globalization has also benefited countries with large-scale industries. Countries such as China, India, Bangladesh and Vietnam have moved from being a primarily exporters of primary commodities to facusing on large-scale manufacturing and services.

Globalization improves access to new technologies, which provides unique opportunities for countries in the developing world to raise their incomes. Nevertheless, countries differ widely in terms of their abilities to upgrade and accumulate skills. Research and development are often lacking, which makes it difficult to take advantage of technological progress. The difficulty for developing countries is that in order to succeed at globalization, you must be able to innovate and produce high-value products.

Globalization also benefits states that were equipped with certain endowments and infrastructure. Low levels of material available to the poorest countries do not allow them to 'play on a level playing field with the forces of foreign trade unleashed by globalization.

3.9 Conclusion

Having understood: 'terms of trade' and its relation with dependency theory that emerged in the 1950s, we have explored here unequal exchange as exploitation —a fundamental aspect of the contemporary capitalist global economy. Thereafter, we discussed here, in the open economy context, the role of FDI in the contemporary world and its power, as an engine of growth, as much for global divergence as for convergence

as well as the role of the World Bank playing for human development growth., also hinting in this connection at transfer of technology and its advantages. Last of all, we have discussed one of the hotly debated issues as globalization and development.

3.10 Summary

Dependency Theory: Theory of economic development, derived from Marxism, arguing that the poverty of low-income countries stems directly from their exploitation by wealthy countries and transnational corporations.

The concept of dependency was first formulated by Raul Prebisch in *The Economic Development of Latin America and Its Principal Problems* (1950) and was later expanded upon in the 1960s and 1970s. This theory was developed with particular reference to development issues in Latin America. It has since been more widely applied and utilized in more general analysis of the global economic system and issues of development worldwide. Dependency theory emphasizes the relationship between the core and peripheral economies. The engagement of the core with the periphery via foreign direct investment leads to a flow of wealth that Andre Gunder Frank (1966) described as a 'sucking out' effect. Andre Gunder Frank argued that the operation of the capitalist world economy meant that the Third world had to be kept in permanent state of underdevelopment, and by the sociologist Immanuel Wallerstein, who conceived the idea that the global economy could be seen as a 'world system' in which the West was the 'core', while the Third World was an exploited 'periphery'. This unequal exchange of goods and services is also characterized by biased trade agreements, debt repayments and the exchange of relatively low-priced raw material for higher-priced manufactured goods.

Once a peripheral economy is tied into a trading relationship with the core it becomes impossible for them to break away and establish economic autonomy, as they become dependent on the core for aspects of security, technology transfer and markets for their goods.

We may cite an example for *Dependency in action*: Kenya: Kenya's main exports are tea, horticultural products, coffee, fish and cement. Kenya's main imports are machinery, transport equipment, refined petroleum products, motor vehicles, iron and steel, resins and plastics. This indicates that the imports tend to have a much higher market value, thereby creating a trade deficit. Further, there is a pressure from the IMF to

liberalize Kenya's economy that further disadvantages Kenyan manufacturing industries and welfare provision.

Prebisch- Singer Thesis: The argument that the gains from trade are not equally distributed between the centre and peripheral countries came to be known as the "Prebisch- Singer Thesis." Raul Prebisch and Hans Singer, both at a United Nations conference in Havana in 1949, presented their manifestos. They argued that the terms of trade between primary goods and manufacturers were destined to decline over the long term, leaving developing countries dependent on the export of raw materials and agricultural products at a growing disadvantage. The implication was that the only way in which countries could escape the trap of declining terms of trade and underdevelopment was to end their dependence on the advanced economies by stopping the import of manufactured goods and export of primary goods.

Prebisch-Singer hypothesis challenged Ricardo and the neo-classical views of comparative advantage, by arguing that if left to the market, developing countries would suffer from increasingly uneven development.

Peripheral countries: Countries that have a marginal role in the world economy and are thus dependent on the core-producing societies for their trading relationships.

Semi-peripheral countries: Countries that supply labour and raw materials to the core industrial countries and the world economy but are not themselves fully industrialized.

Unequal exchange: Trading which is systematically biased against one party because of a movement in the net barter terms of trade or because of an unequal distribution of productive assets.

Net barter terms of trade: The ratio of an index of export prices to an index of import prices; the most commonly used measurement of the terms of trade.

FDI : Foreign direct investment (FDI) is an investment made by an investor from another country in tangible capital assets like infrastructure, production unit, etc.

Transfer of technology: The process of transferring (disseminating) technology from the person or organization that owns or holds it to another person or organization. It occurs along various axes: Among universities,from universities to businesses (and vice versa), from large businesses to smaller ones (and vice versa), from governments to businesses (and vice versa), across geopolitical borders, both formally and informally. Often it occurs by concerted effort to share skills, knowledge, technologies, methods of

manufacturing, samples of manufacturing, etc. The main objective of Transfer of Technology is to make Technologies and Product available for use by everyone. It also contributes to the economic development of organization, nation and region. Example: Some of the mechanisms that make technology transfer possible include: joint research, cooperative agreements, licensing, technical meetings, trade shows, and information dissemination.

Four different types of capital flows: The first is *foreign direct investment*, the second *equity investment,* the third *bond finance and debt issuance* and the fourth *commercial bank lending.*

3.11 Exercises

A. Short-answer type questions

1. What is economic Dualism?
2. What is Prebisch-Singer Thesis? What is the implication of the thesis?
3. A. Emmanuel has used the Marxian theory of transformation of value into prices to show that Less developed countries (LDCs) are compelled to sell their goods at prices below their values and to purchase goods from Developed Countries(DCs)at prices above their values. Many scholars articulate that Emmanuel's argument is preposterous. What did the scholars say in this context?
4. What would it take to increase the benefits of globalization for development?
5. Mention four different types of capital flows.
6. How does agricultural protectionism not only impact negatively on poor people in poor countries and people in the rich countries ? Explain.

B. Medium-answer type questions

1. What is the meaning of technology transfer? What are the objectives of technology transfer?
2. Can Globalization harm development? Briefly explain.

3. Explain the role of FDI in economic growth.
4. Discuss the trend of FDI since the 1980s with its convergence and divergence effects.
5. Can FDI lead to faster growth in developing countries?
6. What role does the World Bank play in the contemporary world?
7. How different types of capital flows rule the world?
8. Explain the terms : foreign direct investment, equity portfolio investment, bond finance and debt issuance, and commercial bank lending

C. Long-answer type questions

1. What is the meaning of technology transfer? Why is technology transfer? What are the objectives of technology transfer?
2. Outline the main arguments of hyperglobalizers, sceptics and transformatioists. Is globalization is a falsifiable theory? What evidence would be conclusive in this regard?
3. List what you consider to be the main consequences of globalization. Are these primarily positive or negative for the developing countries? Do people in the developed countries stand to benefit most from globalization?
4. Globalization can have both positive and negative impacts. Elucidate

   Or

   Elucidate the impact of globalization on levels of poverty and inequality.
5. Write a short note of globalization and development.
6. Who benefits from globalization?

3.12 References

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Unit 4 ❑ Institutions and Development

Structure

4.1 Objectives

4.2 Introduction

4.3 A Framework for the Study of Institution:

4.3.1 Vertical Hierarchies and Horizontal/ Circular Networks

4.3.2 Examination of Vertical Hierarchies

4.4 Government and Corporation

4.5 Role of State in Growth and Development

4.6 Conclusion

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4.8 Exercises

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4.1 Objectives

After reading this unit, you will be able to:

- Understand the definitions of institutions and the necessity of building higher quality institutions in specific areas;
- Learn about an ideal framework for the study of institution along with identifying how specific features of state institutions affect economic performance;
- Have a first-hand knowledge about Vertical Hierarchies and Horizontal/ Circular networks;
- Examine vertical hierarchies;
- Explore the functioning of government and corporation, and
- Indentify in what way state's role promotes growth and development

4.2 Introduction

Institutions correspond generally to somewhat broader concept. They encompass formal and informal rules and regulations that not only dictate the function of the State, but also govern those of private entities.

The experience of some successful countries indicates that building higher quality institutions in specific areas where constraints of growth are most stringent can lift the economy to a higher growth path. Successful economic transformation depends on creating institutions.

It is difficult to pin down exactly what institutional "quality" should be pursued in order to support sustained growth processes. Such features appear to be inherently country- and- context specific. Looking at economic history, it appears that building better institutional frameworks in specific areas can be sufficient to lift binding constraints on growth and initiate a sustained growth process. In the 17th century, protecting a broad group of trade merchants in the Netherlands and Great Britain from arbitrary interference in the exercise of their property rights and building an effective and extensive legal system to safeguard those rights constituted one of the foundations for the sustained growth process of these countries. More recently, China's reform of rural and agricultural institutions that began in the late 1970s laid the groundwork for its current economic success.

Furthermore, successful economic performance within the the context of a market system depends on creating institutions that guarantee not just the better functioning of the markets but also social cohesion.

4.3 A Framework for the Study of Institution

An **institutional framework** is the precondition for the successful implementation of interventions. Institutional frameworks not only bridge the gap between formal requirements and implementation, but also increase the impact of regulatory policy. The term "institutional framework" refers to a set of formal organizational structures, rules and informal norms for service provision.

Although there can be no single blueprint for institutional frameworks, but we can speak how researchers conceptualize institutions, as well as theories about their impact on development.

Institutions in Theory

Mainstream economists maintain that the central economic problems are the allocation of resources, the distribution of income, and determination of the level of income, output and prices. In contrast, institutional economists assert the primacy of the problem of the organization and control of the economic system, that is, its structure of power. Thus, whereas orthodox economists have a strong tendency to identify the economy solely with the market, institutional economists argue that the market is itself an institution, comprised of host of subsidiary institutions and interactive with other institutional complexes in society (Tool, 1993).

Institutionalists are generally less concerned with price and resource allocation *per se* and more with the problem of organization and control of the economy. Institutionalists are interested, for example, in the formation and role of institutions, and the interrelations between economic and legal systems.

Principal themes of Institutional economics include the following :

1. A theory of social change, and an activist orientation towards social institutions, through focusing on both the impact of institutions on economic performance and the process of institutional changes.
2. A theory of social control and collective choice, or a theory of institutions. It focuses on the formation of opportunity sets.
3. A theory of the economic role of government , as a principal social process.
4. A theory of technology, as determining the relative scarcity of all resources.
5. The fundamental principle that the real determinant of resource allocation is not the market but the organizational-institutional, power-structure of society.
6. An emphasis on facets of the value conception.

What are institutions?

The study of institutions has become widespread. But the question crops up : what do institutions actually refer to? Douglas North offers one of the most frequently used

definitions: 'Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction.' (*North,1990*:3). This expansiveness of this definition underscores the fact that institutions are extremely varied in nature. That said, all institutions do share a common characteristic: they are rules and procedures that structure social behaviour.

It is important to note that though the terms 'institutions' and 'organization' are often used interchangeably, they are distinct concepts. North helps to clarify the distinction: If institutions are the rules of the game, organizations and their entrepreneurs are the players. Organizations are made up of individual rules bound together by some common purpose to achieve certain objectives' (*North, 1994*:361). In other words, organizations are a subset of institutions, which are far broader in nature. Some institutions, like political parties and schools, are organizations; others, like elections, are not.

Institutions under this conceptualization can be formal and informal. Formal institutions are fairly straightforward: they are legal rules that are subject to third-party enforcement (*Rodrik , 2008*: 510). Things like constitutions and bureaucracies fall into this category. Informal Institutions are a bit trickier to define and identify. They typically refer to norms and established pattern of behavior. Examples here would include social conventions and moral codes. The institutional framework has primarily focused on formal institutions, not because that researchers doubt the importance of informal institutions, but simply because the former are easier to recognize and measure. Informal institutions also help explain behaviours and outcomes but are far from difficult to research in methodologically sound ways.

Here we look exclusively at a subset of formal institutions: institution of the state. These refer to institutions that are either created or supported by a government. A political party that is legal but does not have ties to the government, for example, would be considered a state institution using this definition. We focus on state institutions here.

Why Institutions matter for economic development?

The authors like Dany Rodrik, Arvind Subramanian and Francesco Trebbi in their *Institutions Rule (2002)* argue that state institutions are the critical factor in predicting income levels across the world. In their study, the quality of institutions 'trumps everything else.'

Economists like Daron Acemoglu and James Robinson , for example, assert in their 2012 book, *Why Nations Fail,* that economic development is almost entirely dependent on a state's institutions. The right set of institutions leads to higher incomes and improved human welfare in the long term, while the wrong ones lead to prosperity for a small group of elites, but poverty for virtually everyone else. The overall message from this is clear : state institutions have to be contoured appropriately to enable positive economic performance.

States with poorly designed institutions will lack incentives to pursue the right economic policies for growth. Indeed as renowned economist Williams Easterly (2009) writes in his article *The Rich Have Markets, the Poor Have Bureaucrats*, 'The consensus among most academic economists is that destructive governments … explain the poverty of nations. The second is that even with the right economic policies for growth in place, poorly designed institutions will limit their efficacy, the so-called 'governance-policy gap'. Too much state corruption and bureaucratic red tape, for example, will prevent even the most open economies from attracting investment. World Bank economist Daniel Kaufmann emphasizes this reality, asserting that despite significant strides in improving developing states' economic policies, improvements in governance are not keeping pace.

Within political science, there is a virtual consensus that institutions are an important feature of the state. Samuel Huntington puts it well: 'the most important political distinction among countries concerns not their form of government but the degree of government'.

Institution in practice

The previous section makes clear that Institutions matter for economic development. It has become a common adage in development circles to say, 'get institutions right'. We have already defined state institutions as those institutions that are created or supported by government. But this is a broad definition. But how can we better understand what this institution look like? To get a more precise picture, we break down into four functional categories — administrative, judicial, political and security— which, taken together, provides a comprehensive of those state institutions that affect a country's economic development.

There are a number of reasons why greater specificity is desirable. The first is that different state institutions affect economic development in different ways. For example, some types of institutions affect levels of corruption within a state, but are not relevant to property rights protection, both of which influence economic growth. Understanding the specific pathways that link institutions to growth can enable the policymakers to prioritize where limited resources should be allocated to mitigate or solve a state's specific obstacles to growth.

Moreover, different states have different administrative and political challenges that constraint their development. Columbia, for example, has *developed* institutions that effectively protect private property, but is lacking institutions that help preserve public order. So thinking in concrete terms, it is helpful for developing context-specific policies to promote growth and development.

In this section, therefore, we focus on identifying how specific features of state institutions affect economic performance. We here discuss **four types** of institutional domains:

(i) **Administrative institutions**: Institutions of the state engaged in policy implementation and the regulation and redelivery of services. Examples include: state ministries, bureaucratic agencies. Administrative institutions are important because societies need a capable administration to keep order, collect revenue, and, carry out programmes. They execute and enforce government- mandated regulations and provide basic goods and services to citizens, including health care, infrastructure development and education. In *Economy and Society* (1978), Max Weber argues that administrative institutions play a pivotal role in providing the state with the appropriate structure to encourage capitalist growth. In his view, administrative institutions should consist of a formalized, standardized, hierarchical and specialized structure. The staff should comprise professionals who are promoted, based on merit rather than political affiliations, loyalty or other clan networks. Their behaviour should be predictable, transparent and objective, driven by a standard set of procedures. To reward such officials, the state should offer adequate compensation, including competitive salaries and long-term career rewards. These features lead to an administrative structure that is capable of and competent in fulfilling its responsibilities and the mandates of the state.

High-quality administrative institutions, therefore, have three key features : (a) meritocratic recruitment and promotion; (b) salary competitiveness, and (c) autonomy. Administrative institutions that have all three features are high in quality. In practice, many states have some, but not all of them.

(ii) **Judicial institutions:** Institutions of the state engaged in law interpretation and enforcement, the distribution of punishments and conflict mediation. Concepts such as property rights and the rule of law are components of judicial governance**.** Examples include: the courts.

Without judicial institutions, state policies have no bite as citizens would likely ignore or manipulate rules and regulations in their interest. We say no word here about informal judicial institutions, such as tradition, customary norms, religious law etc.

High quality judicial institutions are imbibed with four features: (a) independence, (b) integrity, (c) transparency and efficiency, and (iv) equal access. There has been increasing recognition that to be successful, the development process must be comprehensive and supported by an effective judicial system.

(iii) **Political Institutions:** Institutions of the state engaged in decision making, articulation of policy and the selection of public officials. Examples include: political parties, elections. During the election process, human rights are respected. Citizens' votes dictate who is elected. In this context, citizens have the power to hold political officials accountable for their behavior; they can unseat those leaders who deem to be unfit. This happens under the canopy of high –quality political institutions. It is a matter of debate whether the causal arrow between democracy and institution are direct and vice versa.

(iv) **Security institutions**: Institutions of the state engaged in law enforcement, border control, citizen protection and defense. Examples include: military and police forces. The key features of high –quality security institutions are: (a) professionalization, (b) centralized military command structure, (c) civilian accountability

The Institutional Changes that have Occurred in India and China : A Case Study

In the case of India, effective land reform involved only stricter enforcement of the existing tenancy law. The country had enacted a land-reform act in 1955 but did not enforce the law legally largely because of the lack of administrative and resources. During the 1970s, however, the State of West Bengal launched a new programme, called Operation Barga, which was designed to enforce tenancy laws that regulated rents and accorded security of tenure to sharecroppers. Because of loopholes in the law and little administrative support for poor and often illiterate sharecroppers, very few of them had actually registered with the State. Under the Operation Barga project, those sharecroppers were encouraged to register with the Department of Land Revenue and supported by the State in doing so. Owing to the success of the Operation Barga, 65% of share tenants had been registered by 1993, as compared with 15% before the projects began.

As a result, the State of West Bengal had experienced a significant jump of in the growth rate of production of rice, its major food crop during the period 1977-94. And the rural poverty rate declined during the period. It indicates that the land reforms–constituting a change in the governance system–clearly influenced the incentives of farmers to improve the soil, and to invest in new equipment, new seeds and new techniques. It indicates that governance restricting with some institutional change can make havoc.

The Gradualist Approach : China

China can be taken as an example of successful institutional change. In the 1950s through the mid-1970s, China was deeply impoverished and growth rates were negative. Under the leadership of Deng Xiaoping, the Chinese economy has been growing at a rapid pace since the initiation of its reform policies in the late 1970s. The gradual reform endowed the economy with success, removing the constraints arising from a rigid bureaucracy. As described by Deng Xiaoping, Chinese economic reform has been a process of "crossing the river by groping for the stepping stones" and one where no stereotype reform package was adopted. Designed with a pragmatic vision, institutional reform has been immune to ideological considerations and economic development has been laid down as the ultimate goal.

China's transition to market economy has been a gradual process of economic reform which can be characterized as having taking place in 3 stages :

1. Reform (from 1978-1993) had been carried out to improve incentives and improve the scope of the market for resource allocation. This first stage had been characterized by successful agricultural reform and the dual- track price-setting system that combined elements of central planning with free market principles. Farmers were allowed to sell surplus crops freely at a market determined price only after they had fulfilled their obligations to the state under the statye system. The dual- track approach was eventually employed in other areas as well, such as industrial good (like coal and steel). Researchers have referred to this as an ingenious system that generated efficiency without creating any losers. The result of China's dual-track approach to development was impressive. China has sustained near-double-digit growth rates for several decades.
2. The second perido began in 1994 at which time the Chinese Government decided to set the eventual establishment of a modern market system as the goal of reform. From 1994 to 2000 (the most challenging time), several radical reforms were implemented, namely, the unification of official and swap exchange rates, the reform of taxation and fiscal systems, giving central bank its full power in maintaining price stability and promoting economic growth, the experimental privatization of Small-Scale State-owned enterprises and establishments of a social safety net.
3. The third stage (the most recent stage) has put a stronger emphasis on the need to deal with the growing regional and income disparities generated by the accelerated growth process.

Chinese experience underlines the importance of viewing institutional reform as a process, rather than as a one-off event, and of ensuring progress both in the reform effort and in economic development.

4.3.1 Vertical Hierarchies and Horizontal/ Circular Networks

Recent studies indicate that the network, a firm is embedded in, is becoming increasingly more important for the development and implementation of innovation than

the firm itself (*Omta, 2002*). Networks increase the flow of information and thus play an important role for the diffusion and adoption of innovations. Hence, a network is the place where actors within one or between several related industrial sectors interact and collaborate to add value for the customer (*Omta, 2004*).

A networking refers to a process of identifying and acting on complementary interests with or without formal means of cooperation and plays an important role for the diffusion and adaptation of innovations, because they increase the flow of information. Two types of networks exist. Vertical networks/or vertical hierarchies and horizontal hierarchies. Vertical hierarchies, the most traditional form, relate to cooperation of partners belonging to the same chain, generally adopted by larger, more established businesses, characterized by a pyramid-like model that integrates levels of management spanning from low to high, while horizontal networks refers to cooperation among firms which are primarily competitors.

On the one hand, vertical networks are well developed based on quality assurance schemes and traceability, though these networks often face difficulties due to high lack of trust. On the other hand, horizontal networks are well developed when a producer consortium is involved. However, these networks can be inhibited through strong competition. The partners in traditional food networks focus mainly on innovation related to product characteristics such as new size, form and packaging without changing the traditional character of the product. The main barriers for innovation in the traditional food networks are the lack of understanding the benefits of networking activities for innovation, the lack of trust, the lack of knowledge of appropriate methods and skills, and the lack of financial and physical resources.

So far as the horizontal organization is concerned, we find there are certain advantages and disadvantages of horizontal networks:

Advantages of Horizontal networks

The main advantage of horizontal networks is that employees are free to make important decisions without feeling as though management is second-guessing them. This empowerment can boost morale and motivation and spur creativity in your workers. Decision-making in horizontal organizations is fast because there are no barriers between workers and executives.

Disadvantages of Horizontal Networks

The main disadvantage of **horizontal networks** is that employees may not always make sound decisions without managerial supervision, and those bad decisions can impact your business. Another disadvantage is that without managerial authority, employees may have a hard time achieving consensus when working in teams.

The primary disadvantage of vertical networks in an organization is that rank-and-file employees rarely speak or meet with executives. Decision-making can be slow because there are so many management layers.

4.3.2 Examination of Vertical Hierarchies

The vertical organizational structure is a strict hierarchical structure with power emanating from the top to the bottom. With a chain of command well defined, decisions usually move from the top down through layer by layer, and people at the bottom have the least autonomy. In the structure, each person is supervised by the one directly above him. Employees can clearly monitor their roles and duties.

Advantages

Vertically structured organizations have clear lines of authority, with quicker decision making and better designation of tasks to employees. Staffs in a vertical structure have well-defined roles and responsibilities, which reduces duty ambiguity and encourages high production efficiency. For employees who are seeking for a job promotion, there is a clear path to career planning. Employees are motivated to work hard to achieve a higher level.

Besides, the primary advantage of vertical organizations is that all employees know and understand their roles and responsibilities, which can increase productivity. Vertical organizations motivate workers to seek management positions, which often results in them working efficiently to achieve performance standards.

Disadvantages

The vertical organizational structure also has lots of disadvantages. Due to the lack of autonomy, employees from the bottom may have lots of limitations to share their

constructive ideas or creative proposals. Vertical structure is likely to be rigid, which might hamper the company from accepting innovative concepts and trap a company in outdated techniques. What's more, because of multiple layers of powers, it will take more time to respond to a problem or implementing decisions.

One of the primary reasons for vertically integrating is the increase in managerial complexity. This is because entering a new line of work requires a new set of expertise to complement the existing business. A clear result of this is the increase in divestitures to return a company to its core competency.

4.4 Government and Corporation

Government exists to establish justice, ensure domestic tranquility, provide for the common defense, promote the general welfare, It exists solely for the purpose of doing what is in its citizen's best interest.

There arises a stereotype view that in the post-reform scenario, take India , for example, that the government has a smaller role because market now takes over part of what the government has been doing. This is utterly a misperception. In the reform context, the government has, not a smaller role, but a different role, and arguably a more critical one. As has been remarked somewhat paradoxically, more market does not mean less government but different government.

Role of the government

Conceptually, the role of the government in the reform context can be divided into two broad strands. The first strand of the role of the government arises from performing those functions that the government alone can perform. In the transition to a market system, government needs to move out of areas where markets can perform; conversely, government needs to concentrate its efforts and resources in areas where markets do not exist or cannot perform. For example, tasks such as macroeconomic stability, promoting equity, securing the right to property are all government functions which, to use today's terminology, cannot be outsourced to the market. Then there are government functions which arise as a result of market failure. Market failure represents a set of conditions under which markets fail to allocate resources efficiently because of the myopic nature of the market participants. This happens typically in the provision of public goods, in the case of natural monopolies or in situations where there are externalities or

information asymmetries. For example, markets cannot be relied upon to provide external defense or internal security which is public goods. Markets cannot be relied upon to prevent pollution which has a negative externality.

The second strand of the role of the government in the reform context is to 'govern' the market to maximize collective welfare. Market economies are not self-regulating. They cannot simply be left on an autopilot with a government watching from the sidelines. The government has a central role in regulating the market. As David Osborne said in his landmark book, *Reinventing Government*, the role of the government is to "steer, but not row."

Last of all, the government should be more caring and responsive more to the needs of a growing economy and to the concerns of the relatively unserved sections. The fundamental obligation of a democratic government is to provide an administration which is efficient, effective, clean, corruption-free, freely accessible to the people, and it should be based on simple and transparent procedures.

Corporations, on the other hand, do not have such lofty goals. Their objective is to maximize their profits. They have no loyalty to the people. Just to avoid paying taxes,they may shift their headquarters to a distant country. Corporations exist to make a very small number of people extremely wealthy.

A corporation is a legal entity that is separate and distinct from its owners.ÿþ Corporations enjoy most of the rights and responsibilities that individuals possess: they can enter contracts, loan and borrow money, hire employees, own assets. An important element of a corporation is limited liability, which means that shareholders may take part in the profits through dividends and stock appreciation but are not personally liable for the company's debts.

Large corporations are an economic, political, environmental, and cultural force that is unavoidable in today's globalized world. Large corporations have an impact on the lives of billions of people every day, often in complex and imperceptible ways. Sofar as the multinationals are concerned, they were and are transmitters of capital, business systems, technology , products, and services, and they have been managers of complex operations in institutionally and culturally diverse locations. They have been bringers of ' modernity'— higher living standards , consumption, competition, professionalized management, scientific research— but they stand accused of entrenching the disadvantages of home-grown enterprise.

4.5 Role of State in Growth and Development

Today the state has emerged as an active participant in the process of economic development in many ways. Now the governments have started participating increasingly in the productive activities and through its monetary and fiscal policies are guiding the direction of economic activities. It also determines the distribution of goods and services in the economy.

The process of development in case of developed countries was spread over a long period but developing countries today have no time to wait and it is essential for them to cut short the period of development. In this case the government has an important role in the process of development. In order to reduce the various rigidities inherent in a developing country, the state must play the strategic role.

In developing countries planning is not limited to intervention but is regarded as a necessary condition for economic development. Since sources are scarce in developing countries, it becomes necessary to plan their distribution among various projects as well as plan their utilization in these projects.

Thus the developing countries cannot escape planning if they want to develop themselves in a reasonably short span of time which implies that time factor is very important.

The problems prevailing in the developing countries cannot be solved by private enterprises and thus the state action is necessary for the economic development of these countries. It controls over production, distribution, consumption of commodities and to perform this, the government has to devise physical controls and monetary and fiscal measures and these measures are essential for reducing economic and social inequalities that are prevailing in developing countries. "Breaking social chains, and creating a psychological, ideological, social and political situation propitious to economic development becomes the paramount duty of the state in such countries."

The sphere of state action is very vast. It includes, "maintaining public services, influencing the use of resources, influencing the distribution of income, controlling the quantity of money, controlling fluctuations, ensuring full employment and influencing the level of investment."

Thus the state has to shoulder heavy responsibilities in order to ensure rapid economic development in developing countries. This task can be performed by two types of measures i.e. (A) Direct and (B) Indirect.

Types of Measures:

(A) Direct Measures

For the economic development of developing countries state has involved itself directly and performs certain vital functions which are enumerated below:

1. Organizational Changes

The organizational changes play an important role in the process of economic development. It includes the expansion of the size of market and the organization of labour market. The state can develop the means of transport and communications for expanding the size of market because private enterprise cannot be capable of undertaking such schemes.

Moreover, the state can help the growth of agriculture and industries. The organization of the labour market also falls under the functions of government.

It increases the productivity of labour. The government helps in organizing labour by recognizing labour unions. It fixes working hours, payment of wages, establishes machinery for the settlement of labour disputes, provides for social securities measures etc.

This establishes relation between the employers and employees which increases efficiency of labour which in turn increases the production and reduces the cost.

The majority of people, who live in rural areas are engaged in agricultural operations for a fixed period. They are not aware of the employment opportunities in towns and industrial centres. The government can help them in getting jobs by opening information centres in rural areas. Thus the government can help in the mobility of labour.

The problem of urbanization arises, when the labour moves from rural to urban areas and it is solved by the government. Such problems relate to housing, drinking water supply, electricity, slums, transport etc.

2. Social and Economic Overheads

The main obstacle in the way of economic development of developing countries is the lack of economic overheads such as means of communications and transportations, ports, electricity irrigation etc. In industrially advanced countries, these facilities are provided by private enterprises. But in developing countries the private enterprises are not interested to invest because the return is not fruitful and, moreover, such huge investments are beyond the capacity of private sector.

Besides this, there is dearth of entrepreneurial ability in developing countries and the entrepreneurs prefer to invest in trade, housing, gold, jewellery etc. where the rate of return is very high. Thus, it becomes the responsibility of state to provide these economic overheads in the developing countries.

It must also provide the education and training facilities and health services to accelerate the pace of economic development. Economists like Meier and Baldwin observe that the expansion of educational facilities and public health measures in developing countries reduces the obstacle to development.

3. Education:

Education is the focal point of development. Without education the development would be impossible.

4. Public Health and Family Planning

The development and maintenance of public health services are important functions to be performed by the government. It is necessary that the health of people should be maintained to increase the efficiency and productivity of labour.

Meier and Baldwin observe that the public health measures affect economic development in both ways. They facilitate development by improving the qualitative composition of labour force. At the same time, they make need for development.

5. Changes in Institutional Framework

Economic development cannot take place in static institutional framework. The rigid institutional framework is a positive hindrance in the path of development in developing.

Government can provide a stable institutional framework. Paul Streeten has rightly observed that, "The difference between economic growth in advanced countries… and development in so called developing countries is that in the former attitudes and institutions are by and large, adapted to a change and the society has innovations and progress built into the system, while into the latter attitudes and institutions and even policies are stubborn obstacles to development."UNO has rightly observed that, "if the people of a country must desire progress, then their social economic, legal and political institutions must be favourable to it."

According to Lewis, "Every government has to take an attitude on such questions as whether it favours large or small scale enterprise, competition or monopoly, private entrepreneurship, co-operatives or public co-operation and whether its attitude is to be backed by legislation and by administrative action. In addition to helping the evolution of suitable economic institutions, the government can also do a lot in moulding the social and political institutions of a country."

6. Stepping up Rate of Investment:

The process of development is accelerated by increasing the rate of investment. The rate of savings in UDC is highly inadequate as compared to their investment requirements. Thus, it becomes essential for government to accelerate the rate of capital formation.

7. Agricultural Development

The success of the agricultural development programmes depends upon land reform measures taken by the government.

8. Industrial Development

It is the urgent need of the hour that the state should come forward and take measures to formulate and implement a judicious industrial policy. This industrial policy should focus on decentralization of industries which may spread all over the country without any political interference.

In addition to this state should try to prevent the emergence of monopolistic organisations and concentration of wealth in few pockets.

9. Influencing the Use of Resources

Developing countries are generally characterized by under-utilization and mis-utilization of resources. Hence the government must take measures to ensure proper utilization of resources. There is problem of conservation of natural resources like forests and minerals. They should not be allowed to be utilized in a wasteful manner.

Here the government is required to play a role influencing the use of scarce resources. There are also problems of proper land use, proper planning of towns and proper location of industries and it requires long term and comprehensive planning on the part of government.

10. Removal of Inequalities

Another important function of state is the removal or at least reduction of inequalities, both economic and social. There is a great social disparity between various groups of society due to the highly unequal distribution of income. In fact, the economic and social inequalities are closely related to each other.

The government must adopt appropriate measures for the equitable distribution of wealth. It should impose progressive taxes on income and wealth and on luxury goods and benefit the poor through wise public expenditure policy.

11. Optimum Allocation of Resources

The government should improve the mobility of factors of production by furnishing information about employment opportunities by setting employment exchanges and other appropriate institutions.

(B) Indirect Measures:

In an indirect manner, the government can perform a vital function in providing the ever increasing needs of people.

1. Monetary Policy:

A proper monetary policy helps economic and industrial development by increasing the volume of scarce resources, raising the productivity of factor of production, improving

the economic and social conditions and removing the various bottlenecks in the process of economic development. The government may direct the central bank to print notes and send it to poor people's account to save the situation from that attack of Corona virus, so that 40 crore poor people of India, for example, can come back from the quagmire of decay and die.

2. Fiscal Policy:

Fiscal measures, through changes in government revenue and expenditure patterns have increasingly come to be regarded as a desirable instrument of government policy in developing countries. Taxation can be used for increasing savings by restricting consumption and directing investment in promoting channels and preventing it from going into undesired lines.

3. Strengthening of Public Sector:

Though the private sector plays a dominant role in a globalized regime, the role of the state can not overlooked. State can encourage public sector for social welfare of the common masses.

4. Economic Planning:

To come over various problems planned process of priorities has to be followed by the. government to watch that the economic resources are being used for social benefits. In his book *Economic Theory and Underdeveloped Regions* (1957), Gunnar Myrdal argued that planning was a solution to development problems, though he acknowledged that many states in the developing world were 'soft' and unable to achieve development objectives. Other scholars such as D. Seers, and P. Streeten have argued that states have the means and power to promote development.

5. Environment:

State can play a vital role to protect environment. A recent occurrence of corona virus can be successfully tackled by the good promises and actions by the state. State can correct for negative externalities by enforcing laws and regulations.

4.6 Conclusion

Sound institution and good governance can provide the environment in which decisions on long-term investment in both human and physical capital, essential for economic growth, can be made.

It is noteworthy in this connection that there is no one set of governance elements that are the “best” for all countries and for all times. Each country is required to find, by trial and error, its own governance system — the one that works best in its existing context. The advanced countries have developed, over time, an intricate governance and institutional structure to assist in achieving economic growth and have used it to build strong and cohesive societies. The foundation of such a system must be rooted in a shared concept of justice and equality: citizens must believe that they are being treated equally, that changes must be made to the laws and regulations to remove any perceived injustices, and the country is moving in the right direction.

What is important is that the Government itself be credible in its commitment to making the changes that will remove institutional obstacles to growth. Sustained growth is achievable through a careful reform of institutions so that what may be considered to be a just society can be created—one in which the benefits of growth are felt to be shared justly and where the incentives for legitimate economic activity are encouraged and those for rent-seeking are removed.

4.7 Summary

Institutions: Douglas North offers one of the most frequently definitions for institution: ‘Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction.’ The expansiveness of this definition underscores the fact that institutions are extremely varied in nature. That said, all institutions do share a common characteristic: they are rules and procedures that structure social behaviour.

Institutional framework: The system of formal laws, regulations, and procedures, and informal conventions, customs, and norms, that shapes socioeconomic activity and behaviour.

Networking: This refers to a process of identifying and acting on complementary interests with or without formal means of cooperation and plays an important role for the diffusion and adoption of innovations, because they increase the flow of information.

Horizontal networks: Horizontal networks relate to collaboration among firms which are primarily competitors within the same sector or industry. Horizontal networking encompasses initiatives, such as strategic alliances or joint ventures, and they are formed to profit from information exchange, social benefits and informal relationships

Vertical networks: These refer to collaboration of partners belonging to the same chain network. The chain network includes all the organizations (suppliers, focal companies, customers, and third parties) involved in all the upstream and downstream flows of products, services, finances, and information .The focal company is hereby the food manufacturer. Third parties embrace institutions such as research organizations, governmental institutions, and financial providers all related to one chain network. In consequence, a network is the place where the internal and external resources of a firm are combined and transformed into innovation. Through the optimal use of both internal and external resources in the network, a firm can become innovative and able to achieve competitive advantage.

Governance: Good governance is the manner in which the ultimate authority of the State is exexcised in the management of a country's economic and social resources for maximizing social welfare. In the ultimate analysis, it is the quality of governance that separes success and failure in economic development. Because of differences in governance, different outcome arises. Research shows that per capita income and the quality of governance are strongly correlated indicating a virtuous circle in which good governance results in economic development.

The literature has shown that governance has a strong influence on incomes even after the non-economic reasons have been factored out. Developed countries enjoy high living standards because the rule of law prevails, contracts are enforceable, corrupt officials are likely to be caught and punished according to the law, monetary and fiscal policies are prudent and appropriate social safety nets one in place to mitigate unforeseeable risks. Above all, when conflicts arise over issues such as the distribution of income or wealth, and the provision of public goods, these countries have a governance system by which the State is able to arrive at a different arrangement through democratic

processes. A deficient governance system, on the other hand, discourages productive activities and long-term investment, thus depressing potential growth opportunities. It also discourages investment in human capital through education and thus further reduces the chance for sustained growth. Weak governance has often failed to prevent social unrest or, once it has emerged to mitigate its adverse impacts on the society.

4.8 Exercises

A. Short-answer type questions

1. What is institution?
2. What is the distinction between institutions and organizations?
3. What is institutional framework?
4. What is networking?
5. What is 'governance- policy gap'?
6. Two different forms for networks can be distinguished. What are they? Define.
7. What do you mean by vertical networks?
8. What are horizontal networks?
9. Write down the three key features of high-quality administrative institutions.
10. What are the four key features of high-quality judicial institutions?
11. What is governance?

B. Medium-answer type questions

1. Write down the distinction between formal and informal institutions with examples.
2. Explain the reasons why high quality administrative institutions are important.
3. What is the distinction between government and corporation?

4. Write down the direct measures that a state takes for the development of a country.
5. Write down the indirect measures that a state takes for the development of a country.
6. Identify at least three roles that a state performs.
7. Reflect on some essential characteristics of good governance.

C. Long-answer type questions

1. Why is Evidence-based policy-making essential for institutions?
2. Enumerate the role of state in growth and development.
3. What is governance? Analyze in this connection the criteria of good governance and weak governance.
4. What are the main differences between the thinking of mainstream economists and institutional economists? In this context enumerate the principal themes of Institutional Economics.
5. Enumerate the institutional changes that occurred in India and China.

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Unit 5 ❑ Capability Approach to Development

Structure

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5.1 Objectives

After reading this unit, you will be able to:

- Understand what capability approach and its potentiality is;
- Learn about two kinds of inequality;
- Have some idea about capabilities and functionings and the stark distinction between the two;
- Explore freedom and agency with suitable examples; and
- Get answer to A.K. Sen's core question ," Equality of What"?, along with a broad idea of capability approach to education.

5.2 Introduction

Capability can be defined as “a person’s ability to do valuable acts or reach valuable states of being; it represents the alternative combinations of things a person is able to do or be.” (*Sen, 1993:30*). Thus, capabilities are opportunities or freedom to achieve something considered valuable. The significance of this idea rests on its contrast with other ideas concerning how we decide what is just or fair in the distribution of resources.

The central tenet of the capability approach is that in evaluations one must look at each person not as a means to economic growth or social stability but as an end. We must evaluate freedoms for people to be able to make decisions they value and work to remove obstacles to those freedoms, that is, expand people’s capabilities. Importantly, while the capability approach regards each human being as an end, it is not individualistic framework concerned with libertarian notions of self-actualization above all other goods. Rather it embraces “ethical individualism”, a normative approach that stresses that actions should be judged by their effects on individual human beings and that individuals are the “primary objects of moral concern.”

5.3 The Capability Approach and its Potential

A serious attention in mainstream thinking about poverty was being given to non-utilitarian formulation that put freedom as the central issue, most notably in the writings of the Indian economist, Amartya Sen (1980, 1985, 1999). The idea that poverty is fundamentally a lack of individual freedom to live the life one wants— a severe deprivation of basic “capabilities” in Sen’s terms— and that such freedom has an overriding ethical merit, can be traced back henceforth. The capabilities approach aims to address concerns about welfarist approach. This is indeed a new thinking relevant to poverty.

5.3.1 What are Capabilities?

“Capabilities” refer to the set of functionings actually available to a person given his or her circumstances, as determined by the person’s own characteristics and environment. Sen proposed that human welfare should be judged by a person’s capabilities.

In consumer theory, a characteristic is a feature of a good whereas capability is a feature of a person in relation to goods. Capability refers to what a person can do or can be. Capability is achieved through the use of the good. But capabilities are different from characteristics. Capability to function is closer to freedom and if freedom is valued the capability can serve as an object of value and moral importance.

Take the example of a commodity, a bicycle. The most important characteristic of a bicycle is transportation. This characteristic gives the person capability of moving in a certain way. That capability will give the person utility or satisfaction or happiness if that person seeks happiness. A sequence may be as follows:

> A commodity> characteristics > capability to function> utility (pleasure of moving)

It is the capability that comes closest to the standard of living. Ownership is no guarantee. A rich person may be unhappy and farmer may be happy with a cheerful disposition. It is not ownership, not the properties of the commodity but what one can do. Actually capability reflects freedom.

5.3.2 Equality of What?

Following Amartya Sen, we can argue that inequality reduction is crucial both intrinsically and functionally. Intrinsically, inequality reduction is an objective for its own sake as a part of ensuring justice. It is important functionally as it has an impact on the economy and is interlinked to other dimensions. In the preliminary phases, inequality indicates that something is askew with the growth process. The conventional notion regarding inequalities is that they are inevitable as distribution of factors of production is relative to the value they earn. In the production process, the classical Kuznets hypothesis of development reflects this viewpoint. The hypothesis states that economic progress (measured by per capita income) is initially accompanied by rising inequality, but that these disparities get reduced at a later stage as the benefits of development permeate more widely. When the relation between per capita income and Gini coefficient is plotted, it takes a shape of an inverted 'U'. It is assumed that economic growth reduces inequality, and that all individuals would equally benefit from poverty reduction (For detail, see summary).

Nancy Birdsall (2006) in her article distinguishes between two kinds of inequalities: constructive and destructive inequalities. Constructive inequality is good for the economy, wherein it reflects differences in individual's responses to equal opportunities and is therefore consistent with efficient allocation of resources in an economy. Destructive inequality underlines the 'privileges for the already rich and blocks potential for productive contribution of the currently less rich, and therefore contributes to economic inefficiency reducing rather than enhancing the potential for growth'. Birdsall adds that the inequality is more likely to be destructive in developing countries, whereas it is more likely to be constructive in the developed countries, since markets and institutions in developing countries are weak and fragile.

The poverty measures in the monetary approach also use two other aspects of income distribution for assessment purposes; inequality measures like *Gini index* to measure spread, and *income standard* such as mean or median income to measure size. Inequality dimension has also been extended to understand poverty better. The classical Head Count Ratio and poverty gap measure, when estimated on the basis of distribution among the poor, indicates the severity of poverty. Further, applying income distribution methods to Below Poverty Line helps in estimating the depth and severity of poverty. A.K. Sen in his book *On Economic Inequality* , and his article *Poverty: An Ordinal Approach* presented the inequality-adjusted poverty index (also called the Sen Index) and argues that, given the same level of poverty gap and head count among the population, a rise in the Gini index among the poor widens relative income deprivation or the severity of poverty.

5.3.3 Capabilities and Functionings

Functionings: In the scheme proposed by Amarya Sen, "functionings" are the "being and doings" of life, such as being safe, able to live to an old age, employed, and being able to participate in social and economic activities more generally.

Capabilities: "capabilities" refer to the set of functionings actually available to a person given his or her circumstances, as determined by the person's own characteristics and environment. Sen proposed that human welfare should be judged by a person's capabilities. This is an alternative to both the traditional utility–based approach and the specific- deprivation approach , Amrtya Sen rejects " utility" as the sole metric of welfare; he also rejects the non-welfarist formulations, such as those that focus solely on specific

commodity deprivations or incomes alone. He puts: "the value of the living standard lies in the living, and not in the possessing of commodities." In Sen's view, what is valued intrinsically are people's capabilities to function.

"Poverty is a lack of capability." However, the notion of capability "is essentially one of freedom— the range of options a person has in deciding what kind of life to lead".

In what appears is that a core idea in the capability approach is the distinction between capabilities and functionings. Functionings are achieved outcomes. Reading, talking to children, taking part in the social life of a community, being calm, are all functionings. Capabilities are the potential to achieve these functionings, for example, newspaper available to read, living in a society where adults of your class, gender are permitted to talk to children and meeting at a school.

The distinction is important because evaluating only functionings or outcomes can give too little information about how well people are doing. Here is one example of apparently equitable educational outcomes. Suppose, from affluent background and a good school, one wished to experience university before working in her father's business as a trainee manager. An outstanding degree result is not required. Nonetheless she coped well with the academic demands of her course, having been prepared by her school. She enjoyed challenges coming in this context. The second young woman, from a working-class background and a struggling inner city state school, despite significant academic ability, struggled to fit in and make friends among her middle-class peers. The teaching methods at her school had not prepared her well for higher education. Contestation over ideas in class undermined her confidence and made her anxious and unwilling to advance an opinion. She nonetheless struggled hard, desperate to get excellent grades, but her lack of confidence meant she blamed herself for her struggles and was reluctant to approach her teachers for help with work. Both students obtained second-class passes. This shows that similar functionings are producing very different capability sets.

If we look only at the functionings in this example— performance in examinations— we see equal outcomes. But while the functionings of the students are the same, their capabilities are the different. The capability approach requires the real freedom or opportunities. Our evaluation of equality must then take into account of freedom in

opportunities. The capabilities approach, therefore, offers a method to evaluate real educational advantage, and equally to identify disadvantage, marginalization, and exclusion.

5.3.4 Freedom and Agency

Freedom is the capability to do and action, whereas **Agency is the ability to choose an action, i.e,** the latter can be defined in the sense that one is actor of their own actions in a given environment. According to Amartya Sen, (1985), a person's freedom refers to what the person is free to do and achieve in pursuit of whatever goals or values he or she regards as important. A person's agency aspect cannot be understood without taking the note of his or her aims, objectives and — in a broader sense— the person's conception of the good.

What's the difference between the two? Here's an example. You have the agency or ability to make the choice to go to New Delhi, and can make that choice even if you don't have a car or other form of transportation. You have made the choice, despite the absence of the ability to act on that choice. It is the access to transportation that will provide you with the Freedom, or capability, to actually go to New Delhi.

Agency and freedom are often considered to be tightly intertwined. That is, agency is thought to be strongest in an "environment of opportunities" (*Petit, 2001*). Indeed, if a person cannot freely choose a course of action, the very notion that they are an autonomous agent is undermined. Given this, it might be expected that agency and freedom are related such that increasing levels of freedom to choose a course of action correspond to increasing levels of agency.

Martha C. Nussbaum (2011) analyzes and assesses Amartya Sen's distinction between well-being freedom and agency freedom. Nussbaum doesn't use this distinction and believes that "the distinction is obscure and not useful to one who, like Sen, has rejected (on good grounds) utilitarian notions of well-being" (p. 200). Nussbaum believes that by focusing on capabilities rather than functionings and by giving some capabilities, such as practical reason, a central place on her list of fundamental entitlements, that there is no need for the distinction between agency freedom and well-being freedom. Instead, she argues, "because what is valued is the freedom to do or not to do, agency is woven throughout" (p. 201). Yet many philosophers working on the capability approach, such as David Crocker, have endorsed the distinction between well-being and agency and find it a useful distinction.

According to Ingrid Robeyns of Erasmus University, Rotterdam, there is epistemic value in separating the well-being of those people from their agency. Hence he does find agency versus well-being a useful distinction, not only to understand personal choices but also to analyze population-level phenomena, such as the decrease in well-being of informal intensive care-givers who have made a deliberate choice to provide care by themselves rather than having someone else care for their dependents.

5.4 Education in the Capability Approach

This section will mainly highlight Amartya Sen's Capability Approach and Education:

> According to Amartya Sen, a functioning is an achievement, while a capability is the ability to achieve. For example, with regard to higher education, functionings would include, being able to study, being able to participate in university life, in addition to being able to pass an examination or receive a qualification.

Speaking about basic education at the 2003 Commonwealth Education Conference in Edinburg, Sen argues: education has an instrumental role in facilitating people's capacity to participate in decision-making processes at various levels. Therefore it also plays a social role, since literacy is essential to foster public debate and dialogue. Sen also refers to its empowering and distributive role. Education can redress injustice by facilitating the ability of disadvantaged, marginalized and excluded groups to participate in social and political arrangements. Thus education has redistributive effects between social groups, households and within families. Finally, education has transformative potential because people are able to use the benefits of education to help others, as well as themselves.

These comments on basic education can be extended to higher education with increased reach and scope. If basic education is a prerequisite to foster public deliberation, higher education can only improve the process. Similarly, its social, redistributive and transformative roles have greater potency and more effective impact when agents are better educated.

The capability approach provides a useful framework and normative tool to conceptualize and evaluate individual human well-being and social arrangements in any particular context or society. It is not a complete theory of justice, but it does deal with questions of the balance between freedoms and equality that have characterized

work on social justice since the late 18th century. Sen asks the core question, "Equality of what?" As he explains, all egalitarian theories that have stood the test of time pose the issue of equality of something, for example, of income, welfare levels, rights, or liberties. In education this question emerges in philosophical and sociological work on how to theorize and analyze the provision of equivalent learning opportunities.

The capability approach also provides a useful framework and normative tool with which to articulate both the learning processes and social value of education. He further emphasizes that distributing resources and granting rights are not sufficient if the specific capabilities of the individuals are not addressed. The capability approach to education goes beyond both the earlier theories like human capital theory and right-based education, evaluating not just outcomes, but also the links between capabilities and functionings. With the human capital theory, evaluations take the form of examination results or competency tests because the objective is to acquire skills that enhance productivity and employability. In the case of rights-based education, the discourse promotes the intrinsic value of education regardless of what education is expected to achieve. Thus, the questions raised probe into people's aspirations and the opportunities they face as well as the choices they make.

As has been emphasized earlier, the capability approach stresses the importance of conversion factors: given interpersonal heterogeneity, it should be understood that similar educational resources do not necessarily lead to similar learning outcomes. Possessing resources as instruments means that people must be able to convert them into ends, which are functionings. These converting capabilities are highly diverse among people, which weaken the supporting argument for a resource-based equality. Sen's approach considers the equality of capabilities in and through education. What this requires is acknowledgement of the heterogeneity and pluralism of human beings and the connection between individual experience and social arrangements by studying equality in the capability to convert resources into functionings. Therefore, instead of being satisfied with equal levels of input, resources in education, one needs to question if all individuals are free to participate, equally, in education in different settings.

While the rights-based view of education embraces the idea of justice as being equal education for all, the capability approach is based on a more complex notion of justice than equality of input or output. Sen's approach is inspired by Rawls' notion of justice, but goes further to overcome its weaknesses. Rawls has argued that the "primary goods"

at a person's disposition are rights and liberties, powers and opportunities, income and wealth and justice needs to be allocative. In other words, promoting justice, according to Rawls, implies providing people with the resources they need to lead the lives they have chosen. Therefore, it is assumed that equal opportunities for individuals signify equal command over resources. Sen criticizes how Rawls' approach concentrates on "means to freedom, rather than on the extent of the freedom that a person actually has".

The capability approach takes into account the social context that sets the conditions for individual freedoms. The framework is sensitive to diverse social settings and group configurations. At the same time, it brings the focus back on the individual. Focusing on what people can do and be is the approach on education concerned with the capabilities of each individual. In terms of its normative implications the capability approach may thus be interpreted as individualistic. Sen's work is grounded in his ethical individualism, where each person counts.

In keeping with Sen's idea of justice, education should be evaluated according to the impact on people's present and future capabilities. Good education is concerned with wellbeing, which neither depends on consuming resources or inputs, nor or the functionings a person might have achieved. Instead, it depends on the reach and scope of freedoms that people have reason to choose and value.

The 2002 UNESCO Report "Education for all" recognizes the relation between the capability perspective and education, and suggests that policies should be designed and evaluated in the following manner:

They can be "[…] judged to be successful if they have enhanced people's capabilities […]. From this capability perspective, then, education is important for a number of reasons. […] The human capabilities approach to education […] recognizes that education is intrinsically valuable as an end in itself. […] Compared to other approaches] the capability approach goes further, clarifying the diverse reasons for education's importance. Although many of the traditional instrumental arguments for education […] are accepted, the distinctive feature of the human capability approach is its assessment of policies not on the basis of their impact on incomes, but on whether or not they expand the real freedoms that people value. Education is central to this process"

As Madoka Saito (2003) puts it in his article, "Amartya Sen's Capability Approach to Education: a Critical Exploration" :

In short, on the one hand, education is an important factor in broadening human capabilities, which include human capacities. On the other hand, human capabilities play a role in influencing both intrinsic and instrumental values. Therefore, it seems appropriate to say that education plays a role in influencing both intrinsic and instrumental values. What the concept of human capabilities has contributed to this discussion is to clarify the process of influencing intrinsic and instrumental values through education. Clarifying this process helps to show education as concerned with both intrinsic and instrumental values.

5.5 Conclusion

In what follows, education is both the means to achieving, as well as the objective of freedom. Instrumentally, education is a means, by creating and sustaining intellectual development. It is also intrinsically linked, by defining what intellectual development is. In both these ways education plays a role in the removal of substantial barriers to freedom.

The capability perspective has the capacity to elaborate how different dimensions, including assets and commodities, observable outcomes but also unobservable opportunities are related with respect to specific individuals in specific circumstances.

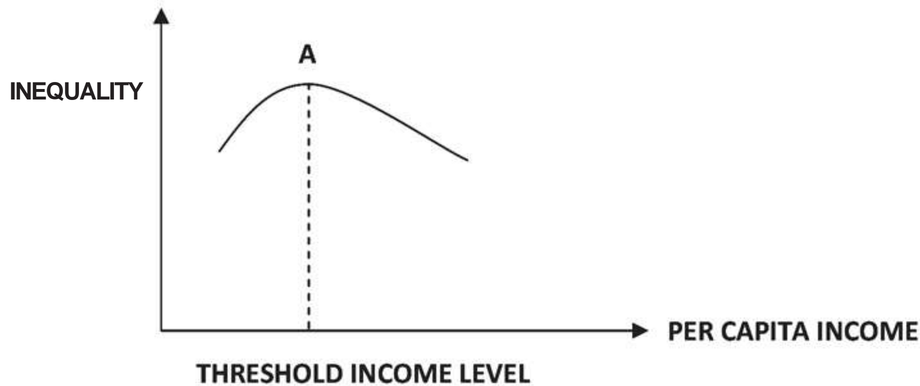
The instrumental and the rights-based view both fall within the framework of the competitive market model. However, these views fail to fully comprehend and respond to needs from a justice-based perspective, where justice is not only concerned with providing primary goods.

The capability approach raises wider questions concerning equality and social justice in education. By distinguishing capabilities from human rights, it requires a change in the way we assess different forms of equality in education. It also addresses how education can affect and influence our thinking about social justice, where justice is conceived as fulfilling present and future capabilities by providing freedoms.

5.6 Summary

Kuznets' inverted U-hypothesis: An influential study in 1955 by Nobel Prize Winning economist, Simon Kuznets suggested that at low income levels, economic growth

tended to create more inequality, as measured by the Gini Coefficient. Once, a critical threshold level of income was reached, further economic growth tended to reduce inequality. This relation has come to be known as **Kuznets' inverted U-hypothesis:** or the Kuznets Curve, from the shape of the curve shown in figure below.



The hypothesis states that economic progress (measured by per capita income) is initially accompanied by rising inequality, but that these disparities get reduced at a later stage as the benefits of development permeate more widely. When the relation between per capita income and Gini coefficient is plotted, it takes a shape of an inverted 'U'. It is assumed that economic growth reduces inequality, and that all individuals would equally benefit from poverty reduction.

The debate over the Kuznets inverted-U hypothesis has generated a vast and often complicated literature. However, the relation Kuznets discovered between income and equity or development is not, in fact, a law of economics, rather a statistical relation, as argued by Anand and Kanbur (1993).

However, the predictions made by Kuznets never fully came to fruition. The problem was that a number of countries never passed the initial stage of industrialization and inequalities rose instead of tapering off. Inequality levels increased in China as the country opened itself up to the world economy. The income share of the poorest quintile decreased from 8% to 7% while the share of the richest quintile increased from 30% to 45% (*Banerjee et al.* 2006:90*)*.

In India after many decades when inequality levels remained stable, the liberalization years led to the explosion of inequality, particularly in urban areas (*Banerjee et al.* 2006:90*)*. Inequality levels can also be sufficiently high to result in rising poverty despite

good underlying growth prospects (Ravallion,1997). Thus the promise that all boats would be lifted with development was incorrect. While economic growth is important, it is not sufficient to lessen inequalities.

Capability Approach: The capability approach rests on a critique of other approaches to thinking about human well-being in welfare economics and political philosophy, which are concerned with commodities, a standard of living,and justice as fairness. The capability approach challenges elements of these formulations and entails a consideration of evaluation, policy, and action that has had considerable impact within development theory.

Constructive inequality is good for the economy, wherein it reflects differences in individual's responses to equal opportunities and is therefore consistent with efficient allocation of resources in an economy.

Destructive inequality underlines the 'privileges for the already rich and blocks potential for productive contribution of the currently less rich, and therefore contributes to economic inefficiency reducing rather than enhancing the potential for growth'.

5.7 Exercises

A. Short-answer type questions

1. What does the Kuznets hypothesis of development state?
2. What is the central tenet of the capability approach?
3. What are capabilities?
4. Define constructive and destructive inequality.
5. Define freedom and agency.
6. What is the difference between agency and freedom?
7. What is the logic behind Matha C.Nussbaum saying that the distinction is between Well-being Freedom and Agency Freedom is obscure and not useful?

8. 'Agency and freedom are often considered to be tightly intertwined'. — Do you agree? Give reasons.

9. The capability approach is not a complete theory of justice, but it does deal with questions of the balance between freedoms and equality. Justify the argument.

B. Medium-answer type questions

1. What is Nancy Birdsall's (2006) view on two kinds of inequalities?

2. How has Rawls' notion of justice been overcome by Sen's approach?

3. What is the difference between capabilities and functionings.

4. What's the difference between the Freedom and Agency? Give examples. Is the distinction valid? Give arguments.

5. How can the Capabilities Approach place a method to evaluate real educational advantage, and equally to identify disadvantage, marginalization, and exclusion ?

6. Why is the capability approach significant for social justice in education?

7. Explain in short, Amartya Sen's new approach to development based on the central concept of capability in which education plays a central role.

C. Long-answer type questions

1. What is the distinction between capabilities and functionings? Why is the distinction very important?

2. How does A.K Sen's capability approach provide a useful framework and normative tool to conceptualize and evaluate individual human well-being and social arrangements?

3. 'In keeping with Sen's idea of justice, education should be evaluated according to the impact on people's present and future capabilities'. How can you justify the statement?

4. What was the definition of development prior to 1970s? How does Amartya Sen expand the definition of development? Has he advocated a human-centred approach to development? What was the net result of his ideas for development?

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Unit 6 ❑ Poverty and Inequality

Structure

6.1 Objectives

6.2 Introduction

6.3 Trends in World Inequality

6.4 Poverty and Inequality

6.4.1 How can the two- Poverty and Inequality - be Measured?

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6.5.1 Advantages of MPI

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6.7 Summary

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6.1 Objectives

After reading this unit, you will be able to:

- Understand the trends in today's Global inequality ;
- Also understand Global Wealth inequality among individuals;
- Learn the distinction between poverty and inequality; and
- Explore Multidimensional Poverty index, its advantages and its implications for India

6.2 Introduction

Questions about poverty are often linked to the issue of inequality. Indeed, from the perspective of relative poverty, the two concepts are intrinsically linked, in the sense that widening inequality effectively means increased poverty. However, the issue of global inequality is an area of particular contention. At best, there has been assertion that the gap between the richest and poorest countries have been increasing. The UN's 1999 *Human Development Report*, for example, noted that the assets of the world's richest three individuals exceeded the combined GDPs of all the countries designated as the world's 'least developed,' comprising a total population of some 600 million people. As the rich get richer the poor get poorer, in relative and perhaps also in absolute terms.

Inequality matters and it affects growth mainly through two mechanisms.

The first machanism concerns the socio-political effects of inquality. Empirical evidences of these effects have been growing as has political evidence. In fact, at the national level, many authors argue that inequality damages the investment climate by creating instability – either in the socio-political environment or in the requlatory environment ensuring property rights. Socio-political instability hurts growth by increasingrisk and uncertainty through regime changes, government changes, encouraging illegal activities and rent seeking.

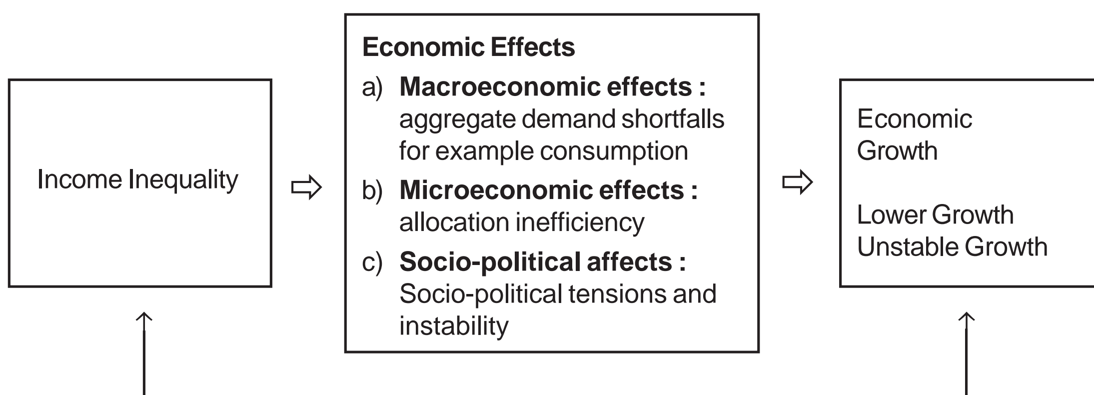

Fig 6.1 : How inequality affects growth ?

The second mechanism is economic working at both the micro and macro levels.

At the micro level, some suggests that inequality if it is too high, can lead to allocation inefficiencies or by creating credit constraints for the poor, thus reducing their access to education, land and other agricultural inputs and to entrepreneurial opportunities. In recent years, a growing body of empirical research has indicated that there is another major mechanism through which inequality matters often significantly (Fig above) i.e. inequality can have affects at the macro level through aggregate demand : widening inequality can create shortfalls in consumption demand. In terms of our understanding of inequality – growth linkage, it is this macroeconomic channel that has witnessed the most significant progress.

6.3 Trends in World Inequality

During the 1990s, more work has focused on the issue of global inequality, H.Theil and his associates examined inequalities across countries and tested for the convergence of real per capita income between the years 1961 and 1986. A total of 113 countries are included in the study. Their finding is that international inequality increased from the early 1960s to the later 1986s, after which it remains approximately constant.

The UNDP (1999) noted that world inequalities have been rising for nearly two centuries. Wade (2001) also argues that world income distribution became more unequal over the last two decades of the 20th century.

Wider inequalities among countries, as well as among income groups within countries, are closely examined in detail in UNCTAD's *Trade and Development Report, 2008*. It shows that since the early 1980s the world economy has been characterized by rising inequality, and North-South income gaps have continued to widen. What we actually witnessed is that from the mid-1970s, domestic income inequality started turning upwards in the OECD (Organization for Economic Cooperation and Development) countries and in Latin America. The 1990s and beyond witnessed a sharp rise in income polarization in the economies in transition. In China, inequality rose sharply from 1978 to 1985, after which it rose faster.

The limited data available for Sub-Saharan Africa suggest that, following structural adjustment, intra-urban inequality rose, while intra –rural inequality rose in Kenya and Zambia. As a result, over the last 25 years, income inequality appears to have risen to various extents and with different effects in 70 % of the countries.

In case of India, Abhijit Banerjee and Thomas Piketty (2001) showed that the share of total income accruing to the top one percent of income earners in the late 1990s had increased from 4 % to almost 11%. In other words, the income gain to the richest decile in India will be about four times higher than the gain to the poorest quintile. The fact is that on average, the rich has captured a much large share of the increment to national income from growth than the poor.

The increasing inequality is rooted in more and less successful developing countries alike, and in all regions, including East Asia, Latin America and Africa. These trends are rooted in a set for forces unleashed by rapid liberalization that make for greater inequality by favouring certain income groups over others.

World Inequality Report, 2018 articulates inequality has increased in most world regions in recent decades, but at different speeds. Income inequality varies greatly across world regions. Income inequality in the United States is among the highest of rich countries It is lowest in Europe and highest in the Middle- East. Inequality within world regions varies greatly. In 2016 the share of total national income accounted for by just that nation's top 10% earners (top 10% income share) was 37% in Europe, 41% in China, 46% in Middle-East, the world's most unequal region according to their estimates, the top 10% capture 61% of national income. In India the income growth of the bottom 40%—58 % between 2000 and 2018—was significantly below the average. At the other end of the spectrum, the top 1 percent saw their incomes grow significantly more than the average since 2000 and since 2007.

In recent decades, income inequality has increased in nearly all countries, but at different speeds, suggesting that institutions and policies matter in shaping inequality. Since 1980, income inequality has increased rapidly in North America, China, India, and Russia. Income Inequality has grown moderately in Europe .From a broad historical perspective; this increase in inequality marks the end of post-war egalitarian regime which took different forms in these regions.

At the global level, inequality has risen sharply since 1980, despite strong growth in China. There has been a reduction in between-country average income inequality, but as within-country inequality has continued to increase.

There has been a general rise in net private wealth in recent decades. In China and Russia there have been unusually large increases in private wealth.

Global Wealth inequality among individuals

At the end of the 20th century, wealth was concentrated among the G8 and Western industrialized nations, along with seven Asian and OPEC nations. A study reports that the richest 1% of adults alone owned 40% of global assets in the year 2000, and that the richest 10% of adults accounted for 85% of the world total. The bottom half of the world adult population owned 1% of global wealth. Moreover, another study found that the richest 2% own more than half of global household assets.

Wealth is substantially more concentrated than income: In 2017 the global top 10% (the richest 10% in the United States, Europe and China) owned more than 70% of the total wealth, and the top 1 % owned 33 %, while the bottom 50 % owned less than 2 %. These estimates are a lower bound, since inequality would probably be higher if Africa, Latin America and the rest of Asia were included. Thus, wealth inequality among individuals has increased at different speeds across countries. Large rises in top-wealth shares have also been experienced in China and Russia following their transitions from communism to more capitalist economies. The top 1% wealth share doubled in both China and Russia between 1995 and 2015, from 15% to 30% and from 22% to 43%, respectively. The rise of the top 1% mirrors the fall of the bottom 50%.

Of late, top 1% own nearly 50% of global wealth and China's wealthy now outnumbers America's. For the first time, China has overtaken the United States to become the country with the largest number of people in the top 10% of world's most wealthy people. China now has a cohort of 100 million individuals who are in the top 10% of global wealth distribution, compared to 99 million for the U.S. In addition, China has surpassed Japan as the country with the second-largest number of millionaires. In 2010, the number of Chinese millionaires was only 38 thousand, while the number in 2019 is now 4.4 million. The number of millionaires in the rest of the world are as follows: Africa has 171 millionaires, Latin America has 673, India has 759.

New York Times columnist Paul Krugman expressed concern that "we are once again living in an era of extraordinary wealth concentrated in the hands of a few people … And this concentration of wealth is growing."

Thomas Piketty's 2014 book, *Capital in the Twenty First Century* claimed that deep economic forces were allowing the rich to amass a rising share of overall wealth

at the expense of workers. One of Piketty's main claims in his book was that wealth concentration is rising because returns on capital in the economy are outpacing economic growth (a hypothesis expressed as $r > g$).

Some Facts on Inequality

Why is rising Inequality a matter of great concern?

High and sustained level of inequality, especially inequality of opportunity can entail large social costs. Entrenched inequality of outcomes can significantly undermine individual's educational and occupational choices. Rising Inequality a matter of great concern for the following reasons:

(i) Income distribution matters for growth

Income inequality (as measured by Gini coefficient, which is zero when everybody has the same income and 1 when one person has all the income) negatively affects growth and its sustainability.A higher net Gini coefficient is associated with lower output growth. More importantly, we find an inverse relationship between the income share accruing to the rich (top 20%) and economic growth.

(ii) Inequality dampens investment, hence growth by fuelling economic, financial and political instability

- **Financial Crises**:

  A growing body of evidence suggests that rising influence of the rich and stagnant incomes of the poor and middle-class have a causal effect on crises and thus directly harms short-term and long–term growth. In particular, studies by Raghuram Rajan and Acemoglu have argued that a prolonged period of higher inequality in advanced economies is associated with the global financial crisis intensifying leverages, overextension of credit , and lobbyists to push for financial deregulation.

- **Global imbalances:**

  Ben Bernanke says that higher top income shares coupled with financial liberalization are associated with substantially larger external deficits.

- **Conflicts:**

  Extreme inequality may damage trust and social cohesion, and thus is also associated with conflicts, which disrupts investments.

(iii) Inequality can lead to policies that hurt growth

In addition to affecting growth drivers, inequality may result in poor public choices. For example, it can lead to a backlash against growth enhanching economic liberalization and market-oriented reforms.

(iv) Inequality hampers poverty reduction

Martin Ravallion argues that inequality affects the pace at which growth enables poverty reduction. Higher inequality makes a large proportion of population vulnerable to poverty.

Major Implications

Inequality has major implications for both social and economic development. Countries with low levels of inequality sustain higher growth rates for longer periods of time. In contrast, countries with high levels of inequality have less stable and efficient economic systems, which can stifle economic growth. One reason for this is that countries with high levels of inequality levels of aggregate demand, which slows down economic growth. Low wages make it difficult for the poorest segments of the population to consume. All of the wealth concentrated among the few does not generate enough demand to stimulate the economy.

Inequality also perpetuates poverty traps. It slows the pace of poverty reduction because it limits opportunities for social mobility and access to health care and education. Much of the populations in countries with high levels of population will see their potential go untapped. Inequality usually means that there are fewer people working, and also more people working only part time, resulting in fewer total working hours.

Inequality in health care can affect long-term development. Health outcomes are important to mobility since adults in poor health will find it more difficult to attain and hold a good job, which leads to lower wages. Additionally, children in poor health have greater difficulty learning and leave school earlier than healthy children. Nutrition is an area where inequalities remain very high. In Latin america, survey data shows that there

are high disparities in countries such as Bolivia, Honduras and Peru, where child stunting in 9 times higher among children from poor households compared to children from rich households. Though life expectancy disparities have decreased across most regions, this has not been the case in Africa.

All regions have made improvements in increasing access to education. We can see, the average number of years spent in school has gone up around the world. In developed countries the average number of schooling increased from 6.1 to 11.3 years, while the average number of years spent in school in developing countries has increased from 2 to 7.2 years. Nevertheless, within countries there still remain high levels of inequality in education. Studies have found that countries with high levels of secondary school enrolment are better above to tackle the major issues of developments such as reducing poverty, improving infant mortality rates, improving life expectancy, reducing maternal death rate and stimulating economic growth.

Generally speaking, while poor countries are more likely to have conflict, countries with high levels of inequality are especially prone to conflict. Additionally, inequalities taking place in ethnic lines produce situations that are particularly conducive to conflict.

In many developing countries the distribution of land ownership is very uneven, which helps to explain why inequalities persist. In Latin America, the ownership of land still remains concentrated in the hands the few. This highly unequal distribution of land creates social and political tensions leading to conflicts. Inequalities in land distribution also have implications for economic growth. Small landowners often do not have access to credit or resources, which could help them increase their productivity lelvels.

6.4 Poverty and Inequality

According to the World Bank (2000), “poverty is pronounced deprivation in wellbeing.” This of course begs the questions of what is meant by *well-being* and of what is the reference point against which to measure deprivation. Perhaps the broadest approach to well-being is the one articulated by Amartya Sen (1987), who argues that well-being comes from a capability to function in society. Thus, poverty arises when people lack key capabilities, and so has inadequate income or education, or poor health, or insecurity, or low self-confidence, or a sense of powerlessness, or the absence of rights such as freedom of speech. Viewed in this way, poverty is a multidimensional phenomenon and less amenable to simple solutions. For instance, while higher average

incomes will certainly help reduce poverty, these may need to be accompanied by measures to empower the poor, or insure them against risks, or to address specific weaknesses such as inadequate availability of schools or a corrupt health service.

Poverty is related to inequality, but distinct from, inequality. *Inequality* focuses on the distribution of attributes, such as income or consumption, across the whole population. In the context of poverty analysis, inequality requires examination if one believes that the welfare of individuals depends on their economic position relative to others in society.

6.4.1 How can the two— Poverty and Inequality— be measured?

Before going into the discussion of poverty measure, we should have a clear vision regarding relative poverty and absolute poverty.

Poverty is a situation facing people whose material needs are least satisfied. Poverty can be defined by some absolute measure (earning below some specified minimum level) or in relative terms (the number of poorest 10 per cent of households for example).

Absolute poverty is measured against some benchmark such as the cost of getting enough food to eat or being able to write one's own name for literacy. Relative poverty is measured against social standards.

For **absolute poverty** we can specify a poverty line, with those below the line being regarded as in absolute poverty, and those above the line not in absolute poverty. The percentage of any given population below the poverty line is the head count index of absolute poverty. Other definitions of absolute poverty are based on a consensual level of income which is required to maintain human existence. Examples of such absolute definition of poverty include the 'dollar-a-day' (now US$1.25 per day) or 'two dollars-a-day' criteria. Concepts of absolute poverty have been used vary widely in international comparisons of poverty. Because the real value of the poverty line remains constant over time, it is possible to make

Relative poverty is defined with respect to what might be defined as a comparator group, and is therefore, closely related to concepts of relative deprivation.

Because the relative poverty line rises as income increases, the implication is that the relative poverty can be reduced, but only if the income distribution becomes more equal. If the income distribution in the country becomes more unequal, then relative poverty is likely to increase. In this sense, although absolute poverty is likely to be reduced over time as incomes rise, relative poverty is always likely to be with us unless income inequality falls significantly.

According to Amartya Sen, poverty is a matter of deprivation, which may be absolute or relative. He stressed on capability to draw the distinction between absolute poverty and relative poverty. He illustrates the capability of a person by the example of a bicycle: it is, of course, a commodity. It has several characteristics. viz., transportation. Having a bike gives a person the ability to move about in a certain way that he may not be able without the bike. So, the transportation characteristics of the bike give the person the capability of moving in a certain way. That capability may give the person utility.

Sen argues that, in the chain—

Commodities → Characteristics → Capability → Utility

Since capability comes closest to the notion of standard of living, therefore poverty is an absolute notion in the space of capabilities but very often it assumes a relative form in the space of commodities or characteristics.

A. Poverty Measures

Poverty: Aggregate poverty measures grapple with three dimensions of the problem of poverty: *how many* people are poor (the head count ratio); by *how much* they fall below poverty line (poverty-gap measure); and for *how long* are they poor – that is, is poverty transient or persistent? There are many measures of poverty, some important measures are given below.

a. The Poverty Head-Count Ratio (HCR)

HCR shows the percentage of people below the poverty line. The *cost of basic needs approach* is most commonly used for estimating the poverty line. It first estimates the cost of acquiring enough food for adequate nutrition—usually 2,100 calories per person per day—and then adds the cost of other essentials such as clothing and shelter.

The choice of poverty line depends on the use to which it will be put: thus, for international comparisons, the \$1/day standard is helpful, while for targeting programs or policies to the poor a relative poverty line suffices. The appropriate choice of poverty line is a matter of judgment, and will therefore vary from country to country.

Thus, $H = \frac{q}{n}$

where q is the number of people below the poverty line and n is the total population.

b. The Poverty-gap measure:

The Poverty Gap is the difference between the poor's income or expenditure and the poverty line. The Poverty Gap Index (PGI) is the ratio of the poverty gap to the poverty line:

$$PGI = \frac{1}{n}\sum_{i=1}^{q}\frac{(z - y_i)}{z}$$

Where, z = poverty line, y_i = income of the ith individual, q is the number of people below the poverty line and n is the total population

c. Squared Poverty Gap:

To construct a measure of poverty that takes into account inequality among the poor, some researchers use the squared poverty gap index. This is simply a weighted sum of poverty gaps (as a proportion of the poverty line), where the weights are the proportionate poverty gaps themselves; a poverty gap of, say, 10 percent of the poverty line is given a weight of 10 percent while one of 50 percent is given a weight of 50 percent; this is in contrast with the poverty gap index, where the gaps are weighted equally. Hence, by squaring the poverty gap index, the measure implicitly puts more weight on observations that fall well below the poverty line. Formally,

$$SPGI = \frac{1}{n}\sum_{i=1}^{q}\left(\frac{z - y_i}{z}\right)^2$$

Where, z = poverty line, y_i = income of the ith individual, q is the number of people below the poverty line and n is the total population

d. Sen's Measure:

Amartya Sen dismissed the conventional method of poverty measurement like Head –count ratio and Income gap ratio because both the techniques ignored the distribution of income, and welfare. Noble Laureate Amartya Sen's measure of evaluating poverty and assessing inequality or S measure of poverty combines three distinctive characteristics of the inter-personal profile of poverty:

1. The head-count ration H
2. The income gap ratio I, as a proportion of the poverty line, and
3. The Gini-co-efficient G of income distribution among the poor derived on the basis of a Lorenz curve.

For fairly large number of Poor people q, the Sen (S) measure of poverty amounts to

$$S = H[I + (1-I)G]$$

Where the head-count ration is H, income gap ratio I, as a proportion of the poverty line, and G is the Gini-coefficient of income distribution among the poor derived on the basis of a Lorenz curve.

S should vary between 0 and 1. When every individual earns an income above poverty level, S = 0 as the number of people with incomes at or below poverty line = 0. Similarly, S = 1, when nobody earns anything. Thus, this measure gives a measure of distribution of poverty among those below the poverty line.

Gini coefficient is a relative measure of inequality.

Unlike Gini coefficient, S coefficient has two distinguishing features: (a) it covers a part of distribution, and (b) it is a measure of absolute poverty.

Besides, The data required to estimate Lorenz curve on Gini coefficient is more than that to estimate S index. These considerations appear to have prompted Amartya Sen to conclude that as a measurement of poverty, S measure is superior both to the usual Head-count ratio as well as to the standard measure of relative inequality.

Randomized Control Trials (RCTs) :

The introduction of *randomized control trials* (RCTs) has added a powerful new method ot the toolbook employed by development experts. The proponents of these trials aim to conduct what are considered to be field experiments that replace, as far as possible, research methods orginally employed in medicine to evaluate the effectiveness of new drugs. Among the first applications of these tools were in the design of conditional cash transfer programmes to improve education and health outcomes. The Bosla Familia programme in Brazil and Prospera programme in Mexico demonstrated the potential for randomized trials and these methods have subequently been utilized in many countries. Abhijit, Banerjee and Esther Duflo in this book 'Poor Economics' argue that it is possible to break cycles of persistent poverty & establish new growth trajectories by providing poor people & policy makers with effective, valid information.

B. Inequality Measures

Absolute poverty and inequality are separate concepts that should not be confused. Absolute poverty refers to a standard of living below some benchmark. The unbroken income distribution in **Fig. 6.2** shows a substantial number of poor people, a large number of middle incomes, and few high incomes. Inequality is concerned not with the absolute living standard of the poor, but with the differences between income groups; the dotted distribution shows more inequality (but less absolute poverty) than the unbroken one.

A second definition of welfare which is often considered in analysis is that of 'relative' poverty, defined as having little in a specific dimension compared to other members of society. This concept is based on the idea that the way individuals or households perceive their position in society is an important aspect of their welfare. To a certain extent, the use of a relative poverty line in the previous sections does capture this dimension of welfare by classifying as 'poor' those who have less than some societal norm.

The overall level of inequality in a country, region or population group – and more generally the distribution of consumption, income or other attributes – is also in itself an important dimension of welfare in that group. Inequality measures can be calculated for any distribution—not just for consumption, income or other monetary variables, but also for land and other continuous and cardinal variables.

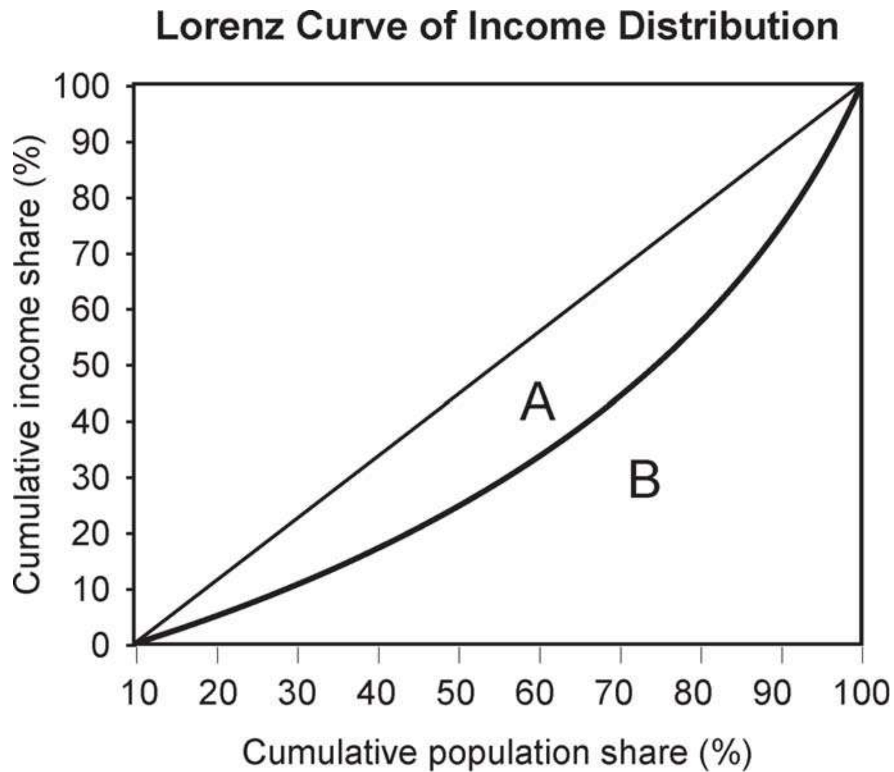

Fig. 6.2

Some commonly used measures of inequality are presented below.

i) Gini-coefficient of inequality: This is the most commonly used measure of inequality, devised by the Italian demographer and statistician Corrado Gini(1884-1965). The coefficient varies between 0, which reflects complete equality and 1, which indicates complete inequality (one person has all the income or consumption, all others have none). Graphically, the Gini coefficient can be easily represented by the area between the Lorenz curve and the line of absolute equality.

On the figure to the right, the Lorenz curve maps the cumulative income share on the vertical axis against the distribution of the population on the horizontal axis. In this example, 40 percent of the population obtains around 20 percent of total income. If each individual had the same income, or total equality, the income distribution curve would be the straight line in the graph – the line of total equality. The Gini coefficient is calculated as the area A divided by the sum of areas A and B. If income is distributed completely equally, then the Lorenz curve and the line of total equality are merged and

the Gini coefficient is zero. If one individual receives all the income, the Lorenz curve would pass through the points (0,0), (100,0) and (100,100), and the surfaces A and B would be similar, leading to a value of one for the Gini-coefficient.

(ii) Atkinson's inequality measure (or Atkinson's index): This is the most popular welfare-based measure of inequality. It presents the percentage of total income that a given society would have to forego in order to have more equal shares of income among its citizens. This measure depends on the degree of society aversion to inequality (a theoretical parameter decided by the researcher), where a higher value entails greater social utility or willingness by individuals to accept smaller incomes in exchange for a more equal distribution. An important feature of the Atkinson index is that it can be decomposed into within and between-group inequality. Moreover, unlike other indices, it can provide welfare implications of alternative policies and allows the researcher to include some normative content to the analysis.

(iii) Hoover index (also known as the Robin Hood index, Schutz index or Pietra ratio): It shows the proportion of all income which would have to be redistributed to achieve a state of perfect equality. In other words, the value of the index approximates the share of total income that has to be transferred from households above the mean to those below the mean to achieve equality in the distribution of incomes. Higher values indicate more inequality and that more redistribution is needed to achieve income equality. It can be graphically represented as the maximum vertical distance between the Lorenz curve and the 45-degree line that represents perfect equality of incomes.

iv) Theil-index: While less commonly used than the Gini coefficient, the Theil-index of inequality has the advantage of being additive across different subgroups or regions in the country. Theil index and General Entropy (GE) measures The values of the GE class of measures vary between zero (perfect equality) and infinity (or one, if normalized). A key feature of these measures is that they are fully decomposable, i.e., inequality may be broken down by population groups or income sources or using other dimensions, which can prove useful to policy makers. Another key feature is that researchers can choose a parameter á that assigns a weight to distances between incomes in different parts of the income distribution. For lower values of á, the measure is more sensitive to changes in the lower tail of the distribution and, for higher values, it is more sensitive to changes that affect the upper tail (Atkinson and Bourguignon, 2015). The most

common values for á are 0, 1, and 2. When á=0, the index is called "Theil's L" or the "mean log deviation" measure. When á=1, the index is called "Theil's T" index or, more commonly, "Theil index". When á=2, the index is called "coefficient of variation".

v) Decile dispersion ratio (or inter-decile ratio): It is the ratio of the average income of the richest x per cent of the population to the average income of the poorest x per cent. It expresses the income (or income share) of the rich as a multiple of that of the poor. However, it is vulnerable to extreme values and outliers. Common decile ratios include: for example, D9/D1: ratio of the income of the 10 per cent richest to that of the 10 per cent poorest; This ratio is readily interpretable, by expressing the income of the rich as multiples of that of the poor.

vi) Palma ratio: It is the ratio of national income shares of the top 10 per cent of households to the bottom 40 per cent. It is based on economist José Gabriel Palma's empirical observation that difference in the income distribution of different countries (or over time) is largely the result of changes in the 'tails' of the distribution (the poorest and the richest) as there tends to be relative stability in the share of income that goes to the 'middle.'

vii) 20/20 ratio or "income quintile ratio": It compares the ratio of the average income of the richest 20 per cent of the population to the average income of the poorest 20 per cent of the population.

There are many measures of inequality that, when combined, provide nuance and depth to our understanding of how income is distributed. Choosing which measure to use requires understanding the strengths and weaknesses of each, and how they can complement each other to provide a complete picture.

6.5 Multidimensional Poverty Index

The Multidimensional Poverty Index (MPI) identifies multiple deprivations at the household and individual level in health, education and standard of living. It uses micro data from household surveys, and—unlike the Inequality-adjusted Human Development Index—all the indicators needed to construct the measure must come from the same survey. Each person in a given household is classified as poor or non-poor depending

on the weighted number of deprivations his or her household, and thus, he or she experiences. These data are then aggregated into the national measure of poverty. The MPI reflects both the incidence of multidimensional deprivation (a headcount of those in multidimensional poverty) and its intensity (the average deprivation score experienced by poor people). It can be used to create a comprehensive picture of people living in poverty, and permits comparisons both across countries, regions and the world and within countries by ethnic group, urban or rural location, as well as other key household and community characteristics. The MPI offers a valuable complement to income-based poverty measures.

Published for the first time in 2010 by the United Nations Development Program (UNDP) and the Oxford Poverty and Human Development Initiative (OPHI), the MPI measures three main dimensions of poverty — health, education and living standards — in 104 developing countries around the world. Multidimensional poverty index (MPI) defines poor not only on the basis on income but other indicators, including poor health, poor quality of work and poor education.

Since its launch of Multidimensional poverty index (MPI) in the 2010 Human Development Report, the MPI has been vocally criticized and the concept has been hotly debated in the sphere of development research. The MPI is based on an ordinal version of the dual cut-off multidimensional poverty measures proposed by Alkire & Foster.

Alkire & Santos (2014) identify three dimensions to be included in the MPI: health, education, and the standard of living. These dimensions mirror the Human Development Index (HDI). They have been chosen because there is consensus that any multidimensional poverty measure should at least include these three dimensions; for the ease of interpretability; and finally for reasons of data availability. Analyzing a sample of 34 countries, Alkire and others (2015) observe statistically significant reductions in multidimensional poverty in 30 countries.

6.5.1 Advantages of MPI

One of the main advantages of the dual cut–off approach is that it is generally open to an unlimited number of indicators. It can therefore capture a much broader definition of poverty and can possibly accommodate several culturally-specific concepts of poverty.

Conversely, if the MPI was focused on fewer indicators (as suggested below) this advantage is not as compelling. The dual cut–off method is also less sensitive to misclassifications and mismeasurement. Most importantly perhaps, the method enables politicians to focus on the simultaneously deprived. However, considering someone deprived but not poor is somewhat confusing, and the dilemma of choosing weights and the possibilities of trade-offs between indicators is real.

Second, the dual cut–off method is also less sensitive to misclassifications and mismeasurement. Most importantly perhaps, the method enables politicians to focus on the simultaneously deprived.

Third, In fact, the data utilized by UNDP to calculate global multidimensional poverty is somewhat more reliable than the one used for the income poverty measure. In contrast to the $1-a-day line, it has the huge advantage of measuring well-being outcomes directly, in line with Amartya Sen's functioning and capability approach (Sen, 1999b,a). Hence, UNDP has a macro level well-being indicator based on the capability approach (the HDI and the IHDI to consider inequalities), and a micro-level deprivation indicator, the MPI, at its disposal.

6.5.2 Achievements of the MPI

The MPI has not been the first attempt in measuring multidimensional poverty. There have been many multidimensional poverty measures proposed in the literature and applied to individual countries. The main contribution of the MPI, as we see it, vis–a–vis the existing work, is its breadth of country-coverage and its international comparability. In 2010 the MPI was calculated for 104 developing countries using just 3 types of datasets.Through this broad coverage, the MPI is, in principle, able to make statements about the extent of global multidimensional poverty in a way similar to those the World Bank's $1-a-day poverty line makes about global absolute income poverty.

A second major achievement is that the MPI, through its base on household survey information, is a much more actionable and policy-relevant indicator for countries and agencies than the HDI. One can decompose the MPI by region, by particular groups, and by indicator, thereby allowing countries to directly see which groups suffer most and in which dimensions they are deprived.

6.5.3 Implications for India

The MPI provides a comprehensive and in-depth picture of global poverty – in all its dimensions – and monitors progress towards sustainable Development Goal 1 (SDG) – to end poverty in all its forms. It also provides policymakers with the data to respond to the call of Target 1.2, which is to 'reduce at least by half the proportion of men, women, and children of all ages living in poverty in all its dimensions according to national definition'.

Three Key findings

- Across 101 countries, 1.3 billion people—23.1 percent—are multidimensionally poor, which means that poverty here is defined not simply by income, but by a number of indicators, including poor health, poor quality of work etc.
- Two-thirds of multidimensionally poor people live in middle-income countries
- Half of the 1.3 billion multidimensionally poor people are children under age 18.

As reported by the *2019 global Multidimensional Poverty Index (MPI) from the UN Development Programme (UNDP), the Oxford Poverty and Human Development Initiative*, India's most vulnerable— including Muslims and residents of the poorest states— see improvements, suggesting they are "catching up" with the rest of society. Although India still has the largest number of people living in multidimensional poverty in the world, the current report says the country has made considerable progress. In particular, India has shown statistically significant progress towards achieving Sustainable Development Goal 1, namely ending poverty "in all its forms, everywhere". In India, there were 271 million fewer people in poverty in 2016 than in 2006 as reported by The 2019 global MPI, from the UNDP, the Oxford Poverty and Human Development Initiative which indicates India saw significant reductions in number of people who are multidimensionally poor but deprived in each of the 10 indicators over this time period. The report says that India's MPI value reduced from 0.283 in 2005-06 to 0.123 in 2015-16. The report also says that Jharkhand in India reduced the incidence of multidimensional poverty from 74.9 per cent in 2005-06 to 46.5 per cent in 2015-16.

Between 2005-06 and 2015-16, India nearly halved its poverty rate, from 55 percent to 28 percent. Oxford Poverty and Human Development Initiative (OPHI) director Sabina Alkire says this represents a historic shift on par with China's rapid poverty reduction over the last few decades including Muslims and residents of the poorest states — suggesting they are "catching up" with the rest of society.

Still, despite progress, Save the Children India's director and experts say India's reduction in poverty doesn't guarantee children better access to rights and quality of life: 'It's not resulting in better health outcomes necessarily, it's not resulting in better quality of learning outcomes and it's certainly not resulting in better protection of children from violence," she told DW, adding that while "many people have been lifted out of poverty, this has not translated into tackling some of the more difficult issues when it comes to children'.

6.6 Conclusion

It is the World Bank's dream to make the world poverty free. But in reality, the task is daunting in the sense that several millions of people have escaped the quagmire of poverty or have been lifted out of poverty, yet many are in poverty traps. Nay, global inequality in income and wealth have increased dramatically. Countries after countries' high struggle to pull out of poverty have become a myth. For example, after eight decades of development planning, alas, India is still preoccupied with measuring poverty and groping in the dark for not taming the rising inequality. We are no wiser than before about poverty and inequality and ways of tackling them.. What a travesty of development planning!

6.7 Summary

HDI: A composite index measuring average achievement in three dimensions of human development— a long and healthy life, knowledge and a decent standard of living.

Multidimensional Poverty Index: Published for the first time in 2010 by the United Nations Development Program (UNDP) and the Oxford Poverty and Human Development Initiative (OPHI), the MPI measures three main dimensions of poverty

— health, education and living standards — in 104 developing countries around the world.

Three dimensions of poverty by 10 indicators are: (i) Health: Nutrition, child mortality,(ii) Education: Years of schooling and school attendance and (iii) Standard of Living: cooking fuel, sanitation, drinking water, electricity, housing , assets.

Lorenz curve: It is one of the simplest representations of inequality. On the horizontal axis is the cumulative number of income recipients ranked from the poorest to the richest individual or household. The vertical axis displays the cumulative percentage of total income. The Lorenz curve reveals the percentage of income owned by x per cent of the population. It is usually shown in relation to a 45-degree line that represents perfect equality where each x percentile of the population receives the same x percentile of income. Thus the farther the Lorenz curve is in relation to the 45-degree line, the more unequal the distribution of income.

Gini index: It is the most widely cited measure of inequality; it measures the extent to which the distribution within an economy deviates from a perfectly equal distribution. The index is computed as the ratio of the area between the two curves (Lorenz curve and 45-degree line) to the area beneath the 45-degree line. The Gini's main limitation is that it is not easily decomposable or additive. Also, it does not respond in the same way to income transfers between people.

Gini coefficient: An alternative approach is to define the Gini coefficient as half of the relative mean absolute difference, which is mathematically equivalent to the Lorenz curve definition. The mean absolute difference is the average absolute difference of all pairs of items of the population, and the relative mean absolute difference is the mean absolute difference divided by the average x, to normalize for scale. If x_i is the wealth or income of person *i*, and there are *n* persons, then the Gini coefficient *G* is given by:

$$G = \frac{\sum_{i=1}^{n} \sum_{i=1} (xi - x1)}{2n.nx}$$

When the income (or wealth) distribution is given as a continuous probability distribution function, continuous $p(x)$, the Gini coefficient is half of the relative mean absolute difference.

6.8 Exercises

A. Short-answer type questions

1. Distinguish between poverty and inequality.
2. What is relative and absolute poverty?
3. What is Lorenze curve?
4. Name several measures of inequality
5. What is HDI ?
6. What is Multidimensional Poverty Index?
7. Name three dimensions of poverty by 10 indicators

B. Medium-answer type questions

1. How Inequality affects the Economy?
2. 'Global Wealth inequality among individuals has increased at different speeds across countries'. How can you substantiate the statement?
3. Why is it that as a measurement of poverty, Sen's measure is superior both to the usual Head-count ratio as well as to the standard measure of relative inequality?
4. What are the advantages of Multi-dimensional Poverty Index (MPT)?
5. What are the implications of MPI in India?
6. India has made considerable progress in MPI but lacks heavily in other indicators of MPI. Do you agree ?
7. The introduction of randomised control trials (RCTs) has added a powerful new method to the toolbox employed by development experts'. Do you agree? Give arguments.

C. Long-answer type questions

1. Examine the trends in Global Inequality. What inference can you draw from this trend?
2. Why is rising Inequality a matter of great concern?
3. Explain the different measures of inequality. Which measure do you consider as best?
4. What are the advantages of Multi-dimensional Poverty Index (MPI)? What are its implications for India?
5. Inequality has major implications for both social and economic development. How do you justify the statement?

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