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DEVELOPMENT ECONOMICS

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UNIT I

INTRODUCTION CONCEPTUALIZING DEVELOPMENT

Economists and statisticians use several methods to track economic growth. The most well-known and frequently tracked is the gross domestic product (GDP). Over time, however, some economists have highlighted limitations and biases in the GDP calculation. organizations such as the Bureau of Labor Statistics (BLS) and the Organization for Economic Cooperation and Development (OECD) also keep relative productivity metrics to gauge economic potential. Some suggestmeasuring economic growth through increases in the standard of living, although this can be tricky to quantify.

Different methods, such as Gross National Product (GNP) and Gross Domestic Product (GDP) can be employed to assess economic growth.

- ❖ Gross Domestic Product measures the value of goods and services produced by a nation.
- ❖ Gross National Product measures the value of goods and services produced by a nation (GDP) and income from foreign investments.

Some economists posit that total spending is a consequence of productive output. Although GDP is widely used, it, alone, does not indicate the health of an economy.

Gross Domestic Product

The gross domestic product is the logical extension of measuring economic growth in terms of monetary expenditures. If a statistician wants to understand the productive output of the steel industry, for example, he needs only to track the dollar value of all of the steel that entered the market during a specific period. Combine the outputs of all industries, measured in terms of dollars spent or invested, and you get total production. At least that was the theory. Unfortunately, the tautology that expenditures equal sold-production does not actually measure relative productivity. The productive capacity of an economy does not grow because more dollars move around, an economy becomes more productive because resources are used more efficiently. In other words, economic growth needs to somehow measure the relationship between total resource inputs and total economic outputs.

The OECD described GDP as suffering from a number of statistical problems. Its solution was to use GDP to measure aggregate expenditures, which theoretically approximates the contributions of labour and output, and to use multi-factor productivity (MFP) to show the contribution of technical and organizational innovation.

Gross National Product

Those of a certain age may remember learning about the gross national product (GNP) as an economic indicator. Economists use GNP mainly to learn about the total income of a country's residents within a given period and how the residents use their income. GNP measures the total income accruing to the population over a specified amount of time.
Unlike gross domestic product, it does not take into account income accruing to non-residents within that country's territory; like GDP, it is only a measure of productivity, and it is not intended to be used as a measure of the welfare or happiness of a country.

The Bureau of Economic Analysis (BEA) used GNP as the primary indicator of US economic health until 1991. In 1991, the BEA began using GDP, which was already being used by the majority of other countries. The BEA cited an easier comparison of the United States with other economies as a primary reason for the change. Although the BEA no longer relies on GNP to monitor the performance of the US economy, it still provides GNP figures, which it finds useful for analysing the income of US residents.

There is little difference between GDP and GNP for the US, but the two measures can differ significantly for some economies. For example, an economy that contained a high proportion of foreign-owned factories would have a higher GDP than GNP. The income of the factories would be included in GDP as it is produced within domestic borders. However, it would not be included in GNP since it accrues to non-residents. Comparing GDP and GNP is a useful way of comparing income produced in the country and income flowing to its residents.

Human Development Index

The Human Development Index (HDI) is published annually by the UNDP and focuses on longevity, basic education and minimal income.

Explaining the Human Development Index It tracks progress made by countries in improving these three outcomes

The inclusion of education and health indicators is a sign of successful government policies in providing access to important merit goods such as health care, sanitation and education.

I. Knowledge: First an educational component made up of two statistics – mean years of schooling and expected years of schooling

II. Long and healthy life: Second a life expectancy component is calculated using a minimum value for life expectancy of 25 years and maximum value of 85 years

III. A decent standard of living: The final element is gross national income (GNI) per capita adjusted to purchasing power parity standard (PPP)

The UNDP classifies each country into one of three development groups:

1. **Low** human development for HDI scores between 0.0 and 0.5,
2. **Medium** human development for HDI scores between 0.5 and 0.8
3. **High** human development for HDI scores between 0.8 and 1.0.

The Human Development Index (HDI) is a measure of economic development and economic welfare. The Human Development Index examines three important criteria of economic development (life expectancy, education and income levels) and uses this to create an overall score between 0 and 1.

- 1 indicates a high level of economic development,
- 0 a very low level.

The HDI combines:

- Life Expectancy Index. Average life expectancy compared to a global expected life expectancy.
- Education Index
- mean years of schooling
- expected years of schooling
- Income Index (GNI at PPP)
- Components of the Human Development Index

What the HDI shows

The HDI gives an overall index of economic development. It has some limitations and excludes several factors that might have been included, but it does give a rough ability to make comparisons on issues of economic welfare – much more than just using GDP statistics show.

Limitations of Human Development Index

Wide divergence within countries. For example, countries like China and Kenya have widely different HDI scores depending on the region in question. (e.g. north China poorer than south-east) HDI reflects long-term changes (e.g. life expectancy) and may not respond to recent short-term changes.

Higher national wealth does not indicate welfare. GNI may not necessarily increase economic welfare; it depends on how it is spent. For example, if a country spends more on military spending – this is reflected in higher GNI, but welfare could actually be lower. Also, higher GNI per capita may hide widespread inequality within a country. Some countries with higher real GNI per capita have high levels of inequality (e.g. Russia, Saudi Arabia)
However, HDI can highlight countries with similar GNI per capita but different levels of economic development. Economic welfare depends on several other factors, such as – threat of war, levels of pollution, access to clean drinking water e.t.c.

Meaning of Human Development:

The term 'human development' may be defined as an expansion of human capabilities, a widening of choices, 'an enhancement of freedom, and a fulfilment of human rights. At the beginning, the notion of human development incorporates the need for income expansion. However, income growth should consider expansion of human capabilities. Hence development cannot be equated solely to income. Income is not the sum-total of human life. As income growth is essential, so are health, education, physical environment, and freedom. Human development should embrace human rights, socio-eco-politico freedoms. Based on the notion of human development. Human Development Index (HDI) is constructed. It serves as a more humane measure of development than a strictly .income-based benchmark of per capita GNP. The first UNDP Human Development Report published in 1990 stated that: "The basic objective of development is to create an enabling environment for people to enjoy long, healthy and creative lives." It also defined human development as "a process of enlarging people's choices", "and strengthen human capabilities" in a way which enables them to lead longer, healthier and fuller lives. From this broad definition of human development, one gets an idea of three critical issues involved in human development interpretation. These are: to lead a long and healthy life, to be educated, and to enjoy a decent standard of living. Barring these three crucial parameters of human development as a process enlarging people's choices, there are additional choices that include political freedoms, other guaranteed human rights, and various ingredients of self-respect. One may conclude unresistingly that the absence of these essential choices debars or blocks many other opportunities that people should have in widening their choices. Human development is thus a process of widening people's choices as well as raising the level of well-being achieved. What emerges from- the above discussion is that economic growth measured in terms of per capita GNP focuses only on one choice that is income. On the other hand, the notion of human development embraces the widening of all human choices—whether economic, social, cultural or political. One may, however, contest GDP/GNP as a useful measure of development since income growth enables persons in expanding their range of choices. This argument is, however, faulty. Most importantly, human choices go far beyond income expansion. There are so many choices that are not dependent on income. Thus, human development covers all aspects of development. Hence it is a holistic concept. "Economic growth, as such becomes only a subset of human development paradigm."

Sen's Capability Approach

The Capability Approach is defined by its choice of focus upon the moral significance of individuals' capability of achieving the kind of lives they have reason to value. This distinguishes it from more established approaches to ethical evaluation, such as utilitarianism or resourcism, which focus exclusively on subjective well-being or the availability of means to the good life, respectively. A person's capability to live a good life is defined in terms of the set of valuable 'beings and doings' like being in good health or having loving relationships with others to which they have real access.

The Capability Approach was first articulated by the Indian economist and philosopher Amartya Sen in the 1980s, and remains most closely associated with him. It has been employed extensively in the context of human development, for example, by the United Nations Development Programme, as a broader, deeper alternative to narrowly economic metrics such as growth in GDP per capita. Here 'poverty' is understood as deprivation in the capability to live a good life, and 'development' is understood as capability expansion.

Within academic philosophy the novel focus of Capability Approach has attracted a number of scholars. It is seen to be relevant for the moral evaluation of social arrangements beyond the development context, for example, for considering gender justice. It is also seen as providing foundations for normative theorising, such as a capability theory of justice that would include an explicit 'metric' (that specifies which capabilities are valuable) and 'rule' (that specifies how the capabilities are to be distributed). The philosopher Martha Nussbaum has provided the most influential version of such a capability theory of justice, deriving from the requirements of human dignity a list of central capabilities to be incorporated into national constitutions and guaranteed to all up to a certain threshold.

This article focuses on the philosophical aspects of the Capability Approach and its foundations in the work of Amartya Sen. It discusses the development and structure of Sen's account, how it relates to other ethical approaches, and its main contributions and criticisms.

It also outlines various capability theories developed within the Capability Approach, with particular attention to that of Martha Nussbaum.

1.The Development of Sen's Capability Approach

a. Sen's Background

Amartya Sen had an extensive background in development economics, social choice theory (for which he received the 1998 Nobel Prize in Economics), and philosophy before developing the Capability Approach during the 1980s. This background can be pertinent to understanding and assessing Sen's Capability Approach because of the complementarity between Sen's contributions to these different fields. Sen's most influential and comprehensive account of his Capability Approach, *Development as Freedom* (Sen 1999), helpfully synthesizes in an accessible way many of these particular, and often quite technical, contributions.

Sen first introduced the concept of capability in his Tanner Lectures on *Equality of What?* (Sen 1979) and went on to elaborate it in subsequent publications during the 1980s and 1990s. Sen notes that his approach has strong conceptual connections with Aristotle's understanding of human flourishing (this was the initial foundation for Nussbaum's alternative Capability Theory); with Adam Smith, and with Karl Marx. Marx discussed the importance of functionings and capability for human well-being. For example, Sen often cites Smith's analysis of relative poverty in *The Wealth of Nation* in terms of how a country's wealth and different cultural norms affected which material goods were understood to be a 'necessity'. Sen also cites Marx's foundational concern with "replacing the domination of circumstances and chance over individuals by the domination of individuals over chance and circumstances".

b. Sen's Concerns

The Capability Approach attempts to address various concerns that Sen had about contemporary approaches to the evaluation of well-being, namely:

(1) Individuals can differ greatly in their abilities to convert the same resources into valuable functionings ('beings' and 'doings'). For example, those with physical disabilities may need specific goods to achieve mobility, and pregnant women have specific nutritional requirements to achieve good health. *Therefore, evaluation that focuses only on means, without considering what particular people can do with them, is insufficient.*

(2) People can internalize the harshness of their circumstances so that they do not desire what they can never expect to achieve. This is the phenomenon of 'adaptive preferences' in which

people who are objectively very sick may, for example, still declare, and believe, that their health is fine. *Therefore, evaluation that focuses only on subjective mental metrics is insufficient without considering whether that matches with what a neutral observer would perceive as their objective circumstances,.*

(3) Whether or not people take up the options they have, the fact that they do have valuable options is significant. For example, even if the nutritional state of people who are fasting and starving is the same, the fact that fasting is a choice not to eat should be recognized. *Therefore evaluation must be sensitive to both actual achievements ('functionings') and effective freedom ('capability').*

(4) Reality is complicated and evaluation should reflect that complexity rather than take a short-cut by excluding all sorts of information from consideration in advance. For example, although it may seem obvious that happiness matters for the evaluation of how well people are doing, it is not all obvious that it should be the *only* aspect that ever matters and so nothing else should be considered. *Therefore, evaluation of how well people are doing must seek to be as open-minded as possible.* (Note: This leads to the deliberate 'under-theorization' of the Capability Approach that has been the source of some criticism, and it motivated the development of Nussbaum's alternative Capability Theory.)

2.Sen's Critiques of Utilitarianism and Resourcism

An important part of Sen's argument for the Capability Approach relates to his critique of alternative philosophical and economics accounts. In particular, he argues that, whatever their particular strengths, none of them provide an analysis of well-being that is suitable as a general concept; they are all focused on the wrong particular things (whether utility, liberty, commodities, or primary goods), and they are too narrowly focused (they exclude too many important aspects from evaluation). Sen's criticisms of economic utilitarianism and John Rawls' primary goods are particularly important in the evolution of his account and its reception.

a. Utilitarianism

Economics has a branch explicitly concerned with ethical analysis ('Welfare Economics'). Sen's systematic criticism of the form of utilitarianism behind welfare economics identifies and rejects each of its three pillars: act consequentialism, welfarism, and sum-ranking.

i. Act-Consequentialism

According to act consequentialism, actions should be assessed only in terms of the goodness or badness of their consequences. This excludes any consideration of the morality of the *process* by which consequences are brought about, for example, whether it respects principles of fairness or individual agency. Sen argues instead for a 'comprehensive consequentialism' which integrates the moral significance of both consequences and principles. For example, it matters not only whether people have an equal capability to live a long life, but how that equality is achieved. Under the same circumstances women generally live longer than men, for largely biological reasons. If the only thing that mattered was achieving equality in the capability to live a long life this fact suggests that health care provision should be biased in favor of men. However, as Sen argues, trying to achieve equality in this way would override important moral claims of fairness which should be included in a comprehensive evaluation.

ii. Welfarism

Welfarism is the view that goodness should be assessed only in terms of subjective utility. Sen argues that welfarism exhibits both 'valuational neglect' and 'physical condition neglect'. First, although welfarism is centrally concerned with how people *feel* about their lives, it is only concerned with psychological states, not with people's reflective valuations. Second, because it is concerned only with feelings it neglects information about physical health, though this would seem obviously relevant to assessing well-being. Not only does subjective welfare not reliably track people's actual interests or even their urgent needs, it is also vulnerable to what Sen calls 'adaptive preferences'. People can become so normalized to their conditions of material deprivation and social injustice that they may claim to be entirely satisfied. As Sen puts it,

Our mental reactions to what we actually get and what we can sensibly expect to get may frequently involve compromises with a harsh reality. The destitute thrown into beggary, the vulnerable landless labourer precariously surviving at the edge of subsistence, the overworked domestic servant working round the clock, the subdued and subjugated housewife reconciled to her role and her fate, all tend to come to terms with their respective predicaments. The deprivations are suppressed and muffled in the scale of utilities (reflected by desire-fulfilment and happiness) by the necessity of endurance in uneventful survival. (Sen 1985, 21-22)

iii. Sum Ranking

Sum-ranking focuses on maximizing the total amount of welfare in a society without regard for how it is distributed, although this is generally felt to be important by the individuals concerned. Sen argues, together with liberal philosophers such as Bernard Williams and John Rawls, that sum-ranking does not take seriously the distinction between persons. Sen also points out that individuals differ in their ability to convert resources such as income into welfare. For example, a disabled person may need expensive medical and transport equipment to achieve the same level of welfare. A society that tried to maximize the total amount of welfare would distribute resources so that the marginal increase in welfare from giving an extra dollar to any person would be the same. Resources would therefore be distributed away from the sick and disabled to people who are more efficient convertors of resources into utility.

b. Resourcism

Resourcism is defined by its neutrality about what constitutes the good life. It therefore assesses how well people are doing in terms of their possession of the general purpose resources necessary for the construction of any particular good life. Sen's criticism of John Rawls' influential account of the fair distribution of primary goods stands in for a criticism of resourcist approaches in general. Sen's central argument is that resources should not be the exclusive focus of concern for a fairness-based theory of justice, even if, like Rawls's primary goods, they are deliberately chosen for their general usefulness to a good life. The reason is that this focus excludes consideration of the variability in individuals' actual abilities to convert resources into valuable outcomes. In other words, two people with the same vision of the good life and the same bundle of resources may not be equally able to achieve that life, and so resourcists' neutrality about the use of resources is not as fair as they believe it is. More specifically, Sen disputes Rawls' argument that the principles of justice should be worked out first for the 'normal' case, in terms of a social contract conceived as a rational scheme for mutually advantageous cooperation between people equally able to contribute to society, and only later extended to 'hard' cases, such as of disability. Sen believes such cases are far from abnormal and excluding them at the beginning risks building a structure that excludes them permanently. The general problem is that such accounts 'fetishize' resources as the embodiment of advantage, rather than focusing on the relationship between resources and people. Nevertheless Sen acknowledges that although the distribution of resources should not be the direct concern in evaluating how well people are doing, it is very relevant to considerations of procedural fairness.

3. Core Concepts and Structure of Sen's Capability Approach

This section provides a technical overview of Sen's account.

a. Functionings and Capability

When evaluating well-being, Sen argues, the most important thing is to consider what people are actually able to be and do. The commodities or wealth people have or their mental reactions (utility) are an inappropriate focus because they provide only limited or indirect information about how well a life is going. Sen illustrates his point with the example of a standard bicycle. This has the characteristics of 'transportation' but whether it will actually provide transportation will depend on the characteristics of those who try to use it. It might be considered a generally useful tool for most people to extend their mobility, but it obviously will not do that for a person without legs. Even if that person, by some quirk, finds the bicycle delightful, we should nevertheless be able to note within our evaluative system that she still lacks transportation. Nor does this mental reaction show that the same person would not appreciate transportation if it were really available to her.

The Capability Approach focuses directly on the quality of life that individuals are actually able to achieve. This quality of life is analyzed in terms of the core concepts of 'functionings' and 'capability'.

- *Functionings* are states of 'being and doing' such as being well-nourished, having shelter. They should be distinguished from the commodities employed to achieve them (as 'bicycling' is distinguishable from 'possessing a bike').
- *Capability* refers to the set of valuable functionings that a person has effective access to. Thus, a person's capability represents the effective freedom of an individual to choose between different functioning combinations – between different kinds of life – that she has reason to value. (In later work, Sen refers to 'capabilities' in the plural (or even 'freedoms') instead of a single capability set, and this is also common in the wider capability literature. This allows analysis to focus on sets of functionings related to particular aspects of life, for example, the capabilities of literacy, health, or political freedom.)

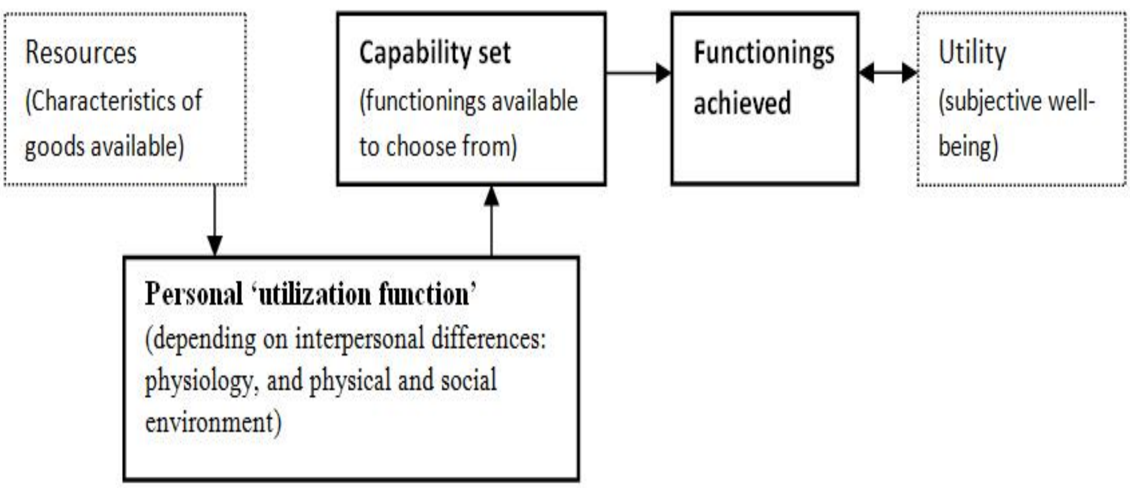


Figure 1. Outline of the core relationships in the Capability Approach

Figure 1 outlines the core relationships of the Capability Approach and how they relate to the main alternative approaches focused on resources and utility. Resources (such as a bicycle) are considered as an input, but their value depends upon individuals' ability to convert them into valuable functionings (such as bicycling), which depends, for example, on their personal physiology (such as health), social norms, and physical environment (such as road quality). An individual's capability set is the set of valuable functionings that an individual has real access to. Achieved functionings are those they actually select. For example, an individual's capability set may include access to different functionings relating to mobility, such as walking, bicycling, taking a public bus, and so on. The functioning they actually select to get to work may be the public bus. Utility is considered both an output and a functioning. Utility is an output because what people choose to do and to be naturally has an effect on their sense of subjective well-being (for example, the pleasure of bicycling to work on a sunny day). However the Capability Approach also considers subjective well-being – feeling happy – as a valuable functioning in its own right and incorporates it into the capability framework.

b. Valuation: Which Functionings Matter for the Good Life?

Sen argues that the correct focus for evaluating how well off people are is their capability to live a life we have reason to value, not their resource wealth or subjective well-being. But in order to begin to *evaluate* how people are performing in terms of capability, we first need to determine which functionings matter for the good life and how much, or at least we need to specify a valuation procedure for determining this.

One way of addressing the problem is to specify a list of the constituents of the flourishing life, and do this on philosophical grounds (Martha Nussbaum does this for her Capability Theory of Justice). Sen rejects this approach because he argues that it denies the relevance of the values people may come to have and the role of democracy (Sen 2004b). Philosophers and social scientists may provide helpful ideas and arguments, but the legitimate source of decisions about the nature of the life we have reason to value must be the people concerned. Sen therefore proposes a social choice exercise requiring both public reasoning and democratic procedures of decision-making.

One reason that social scientists and philosophers are so keen to specify a list is that it can be used as an index: by ranking all the different constituents of the flourishing life with respect to each other it would allow easier evaluation of how well people are doing. Sen's social choice exercise is unlikely to produce collective agreement on a complete ranking of different functionings, if only because of what Rawls called the 'fact of reasonable disagreement'. But Sen argues that substantial action-guiding agreement is possible. First, different valuational perspectives may 'intersect' to reach similar judgments about some issues, though by way of different arguments. Second, such agreements may be extended by introducing 'ranges' of weights rather than cardinal numbers. For example, if there are four conflicting views about the relative weight to be attached to literacy vis-à-vis health, of ½, ⅓, ¼ and $^1/_5$, that contains an implicit agreement that the relative weight on education should not exceed ½, nor fall below $^1/_5$, so having one unit of literacy and two of health would be better than having two units of literacy and one of health.

Sen does suggest that in many cases a sub-set of crucially important capabilities associated with basic needs may be relatively easily identified and agreed upon as urgent moral and political priorities. These 'basic capabilities', such as education, health, nutrition, and shelter up to minimally adequate levels, do not exhaust the resources of the capability approach, only the easy agreement on what counts as being scandalously deprived. They may be particularly helpful in assessing the extent and nature of poverty in developing countries. However, taking a basic capability route has implications for how the exercise of evaluating individuals' capability can proceed, since it can only evaluate how well people's lives are going in terms of the basics.

c. Evaluation: What Capability do People Have to Live a Good Life?

Evaluating capability is a second order exercise concerned with mapping the set of valuable functionings people have real access to. Since it takes the value of functionings as given, its conclusions will reflect any ambiguity in the valuation stage.

Assessing capability is more informationally demanding than other accounts of advantage since it not only takes a much broader view of what well-being achievement consists in but also tries to assess the freedom people actually have to choose high quality options. This is not a purely procedural matter of adding up the *number* of options available, since the option to purchase a tenth brand of washing powder has a rather different significance than the option to vote in democratic elections. For example, Sen argues that the eradication of malaria from an area enhances the capability of individuals living there even though it doesn't increase the number of options those individuals have (since they don't have the 'option' to live in a malarial area anymore). Because the value of a capability set represents a person's effective freedom to live a valuable life in terms of the *value* of the functionings available to that individual, when the available functionings are improved, so is the person's effective freedom.

The capability approach in principle allows a very wide range of dimensions of advantage to be positively evaluated (‘what capabilities does this person have?’). This allows an open diagnostic approach to what is going well or badly in people’s lives that can be used to reveal unexpected shortfalls or successes in different dimensions, without aggregating them all together into one number. The informational focus can be tightened depending on the purpose of the evaluation exercise and relevant valuational and informational constraints. For example, if the approach is limited to considering ‘basic capabilities’ then the assessment is limited to a narrower range of dimensions and attempts to assess deprivation – the shortfall from the minimal thresholds of those capabilities – which will exclude evaluation of how well the lives of those above the threshold are going.

As well as being concerned with how well people’s lives are going, the Capability Approach can be used to examine the underlying determinants of the relationship between people and commodities, including the following (Sen 1999, 70-71):

(1) *Individual physiology*, such as the variations associated with illnesses, disability, age, and gender. In order to achieve the same functionings, people may have particular needs for non-standard commodities – such as prosthetics for a disability – or they may need more of the standard commodities – such as additional food in the case of intestinal parasites. Note that some of these disadvantages, such as blindness, may not be fully ‘correctable’ even with tailored assistance.

(2) *Local environment diversities*, such as climate, epidemiology, and pollution. These can impose particular costs such as more or less expensive heating or clothing requirements.

(3) *Variations in social conditions*, such as the provision of public services such as education and security, and the nature of community relationships, such as across class or ethnic divisions.

(4) *Differences in relational perspectives*. Conventions and customs determine the commodity requirements of expected standards of behaviour and consumption, so that relative income poverty in a rich community may translate into absolute poverty in the space of capability. For example, local requirements of ‘the ability to appear in public without shame’ in terms of acceptable clothing may vary widely.

(5) *Distribution within the family* – distributional rules within a family determining, for example, the allocation of food and health-care between children and adults, males and females.

The diagnosis of capability failures, or significant interpersonal variations in capability, directs attention to the relevant causal pathways responsible. Note that many of these interpersonal variations will also influence individuals' abilities to access resources to begin with. For example, the physically handicapped often have more expensive requirements to achieve the same capabilities, such as mobility, while at the same time they also have greater difficulty earning income in the first place.

4. Applying Sen's Capability Approach

The concept of a capability has a global-local character in that its definition abstracts from particular circumstances, but its realization depends on specific local requirements. For example, the same capability to be well-nourished can be compared for different people although it may require different amounts and kinds of food depending on one's age, state of health, and so on. This makes the Capability Approach applicable across political, economic, and cultural borders. For example, Sen points out that being relatively income poor in a wealthy society can entail *absolute poverty* in some important capabilities, because they may require more resources to achieve. For example, the capability for employment may require more years of education in a richer society

Many capabilities will have underlying requirements that vary strongly with social circumstances (although others, such as adequate nourishment, may vary less). For example, the 'ability to appear in public without shame' seems a capability that people might generally be said to have reason to value, but its requirements vary significantly according to cultural norms from society to society and for different groups within each society (such as by gender, class, and ethnicity). Presently in Saudi Arabia, for example, women must have the company of a close male relative to appear in public, and require a chauffeur and private car to move between private spaces (since they are not permitted to use public transport or drive a car themselves). Strictly speaking the Capability Approach leaves open whether such 'expensive' capabilities, if considered important enough to be guaranteed by society as a matter of justice, should be met by making more resources available to those who need them (subsidized cars and chauffeurs), or by revising the relevant social norms. The Capability Approach only identifies such capability failures and diagnoses their causes. However, if there is general agreement in the first place that such capabilities should be equally guaranteed for all, there is a clear basis for criticizing clearly unjust social norms as the source of relative deprivation and thus as inconsistent with the spirit of such a guarantee.

5. Criticisms of Sen's Capability Approach

This section outlines important criticisms of Sen's approach, together with his responses.

a. Illiberalism

Liberal critics of Sen often identify the focus of the Capability Approach – ‘the ability to achieve the kind of lives we have reason to value’ – as problematic because it appears to impose an external valuation of the good life, whatever people may actually value. Rawls, for example, notes that the reason for liberals to focus on the fair allocation of general purpose resources rather than achievement is that this best respects each individual’s fundamental right to pursue their own conception of the good life. This relates to Rawls’ conception of justice as political rather than metaphysical: it is not the task of justice to assess people’s achievements, but rather to ensure the fairness of the conditions of participation in a society. Justice should be neutral with regard to judging different people’s conceptions of the good. But this neutrality seems incompatible with the Capability Approach’s concern with assessing people’s achievements, which would seem to require a much more substantive view of what counts as a good life than one needs for assessing general purpose resources. Rawls suggests that this constitutes the privileging of a particular (non-political) comprehensive conception of rational advantage or the good.

In replying to this criticism, Sen particularly points to the heterogeneity (variability) in people’s abilities to convert the same bundle of resources into valuable functionings. Theories of justice that focus on the distribution of means implicitly assume that they will provide the same effective freedom to live the life one has reason to value to all, but this excludes relevant information about the relationship between particular people and resources. Even if one abstracts from existing social inequalities or the results of personal choices (‘option luck’), as many liberal theories of justice do, one will still find a substantial and pervasive variation in the abilities of different members of a society to utilize the same resources – whether of specific goods like education or general purpose goods like income. That means that even if it happened that everyone had the same conception of the good, and the same bundle of resources, the fact of heterogeneity would mean that people would have differential real capability to pursue the life they had reason to value. Therefore, Sen argues, a theory of justice based on fairness should be directly and deeply concerned with the effective freedom – capability – of actual people to achieve the lives they have reason to value.

b. Under-Theorisation

Both capability theorists and external critics express concern that the content and structure of Sen’s Capability Approach is under-theorised and this makes it unsuitable as a theory of justice. Sen does not say which capabilities are important or how they are to be distributed: he argues that those are political decisions for the society itself to decide. Many philosophers have argued that without an objectively justified list of valuable capabilities the nature of the life 'we have reason to want' is unclear and so it is hard to identify the goal that a just society should be aiming towards, to assess how well a society is doing, or to criticize particular shortfalls. Different capability theorists have taken different approaches to the valuation of capabilities, from procedural accounts to ones based on substantive understandings of human nature. There are related concerns about the institutional structure of the Capability Approach, for example, brought by the Rawlsian social justice theorist, Thomas Pogge (Pogge 2002). How should capabilities be weighted against each other and non-capability concerns? For example, should some basic capabilities be prioritized as more urgent? What does the Capability Approach imply for interpersonal equality? How should capability enhancement be paid for? How much responsibility should individuals take for the results of their own choices? What should be done about non-remediable deprivations, such as blindness?

Sen's main response to such criticisms has been to admit that the Capability Approach is not a theory of justice but rather an approach to the evaluation of effective freedom.

c. Individualism

Sen's emphasis on individual effective freedom as the focal concern of the Capability Approach has been criticized as excessively individualistic. There are several components to this family of criticisms. Some communitarians see Sen's account as lacking interest in, and even sometimes overtly hostile to, communal values and ways of life because of an excessive focus on individuals. Charles Gore, for example, has argued that Sen's approach only considers states of affairs and social arrangements in terms of how good or bad they are for an individual's well-being and freedom (Gore 1997). But this excludes consideration of certain other goods which individuals may have reason to value which are 'irreducibly social' because they cannot be reduced to properties of individuals, such as a shared language, set of moral norms, or political structure. A related criticism argues that Sen's emphasis on individual freedom is vague and fails to consider how one individual's freedom may affect others. Martha Nussbaum, for example, points out that a just society requires balancing and even limiting certain freedoms, such as regarding the expression of racist views, and in order to do so must make commitments about which freedoms are good or bad, important or trivial (Nussbaum 2003). Others have noted that 'freedom' though broad, is a poor way of conceptualizing certain inter-personal goods such as friendship, respect, and care. A third line of critique takes issue with Sen's 'thin' agency based picture of persons as too abstract and rationalistic. It is said to be founded too closely in Sen's personal dialectical relationship between economics and philosophy, and not enough in the perspectives and methods of anthropology, sociology, or psychology (see, for example, Giri 2000; Gasper 2002). As a result Sen's account is said to have a poor grasp, for example, of the centrality and complexity of *personal* growth and development.

With regard to 'irreducibly social goods' like culture, Sen argues that they not only enter into the analysis instrumentally (such as in the requirements for appearing in public without shame) but also as part of the lives people have reason to value. Nevertheless Sen is clear in his view that the value of social goods is only derivative upon the reflective choices of those concerned (see, for example, Sen 2004a). So if people on reflection don't value such social goods as the traditional religious institutions of their society or continuing to speak a minority language then that should trump the 'right' of those institutions to continue. With regard to freedom, Sen distinguishes the ability to choose between different options from the value of those options. These two together make up effective freedom or capability. Simple freedom to choose may be vulnerable to the objection that it is compatible with invidious freedoms, but the Capability Approach is concerned with people's ability to live a life they have reason to value, which incorporates an ethical evaluation of the content of their options. It is not concerned only with increasing people's freedom-as-power. Finally, Sen's Capability Approach is particularly concerned with grasping the dimensions of human well-being and advantage missing from standard approaches. This relates to its concern with tracing the causal pathways of specific deprivations, with how exactly different people are able or unable to convert resources into valuable functionings. Although this remains somewhat abstractly presented in the formal structure of the Capability Approach, Sen's analysis of, for example, adaptive preferences and intra-household distribution do go at least some way to a situated and sociological analysis.

d. Information Gaps

Sen's Capability Approach is founded on the idea that much more information about the quality of human lives can and should be taken into account in evaluating them. The Human Development Index developed by Amartya Sen and the economist Mahbub ul Haq in 1990 for the United Nations Development Programme's Human Development Reports is the most influential capability metric currently used. However it has been criticized for its crudeness. It contains only three dimensions – longevity, literacy (mean years of schooling), and Gross National Income per capita – which are weighted equally. The Capability Approach is supposed to be interested in assessing how people fare on many dimensions of life including some which seem very difficult to obtain information about, such as people's real choice sets or such complicated capabilities as the ability to appear in public without shame or to form relationships with others. It also requires detailed information on the real inter-personal variations in translating commodities into functionings. It is not clear however that such informational ambitions could ever be realized. Furthermore even the effort of trying to collect such detailed information about people's lives and their 'real' disabilities can be seen as invasive.

Sen was concerned about the crudeness of the Human Development Index (HDI) from the start, but was won over by Mahbub ul Haq's argument for the rhetorical significance of a composite index of human well-being that could compete directly with the crude GDP per capita numbers that have been so influential in development thinking. Thus the HDI does not fully reflect the scope or methodology of the Capability Approach. Nevertheless it has succeeded in demonstrating that capability related information can be used systematically as a credible supplement to economic metrics. Sen accepts that some information about capabilities is easier to obtain than others. Firstly, he argues that we already have quite extensive information about some basic capabilities even for many quite poor countries, such as about health, that can and should be systematically assessed. There is therefore no need to limit our assessment to economic metrics which firstly count the wrong things (means) and secondly also come with significant measurement error despite their apparent numerical precision. Secondly, he argues that if researchers accept the capability space as the new priority for evaluation that will motivate the development of new data collection priorities and methods. As a result more information will become available about how people are faring on the currently 'missing dimensions' of the lives we have reason to value, for example, relating to employment or gender equality in domestic arrangements. Nevertheless, the Capability Approach is not concerned with information collection for its own sake, but rather with the appropriate use of information for assessment. It is therefore not committed to, nor does its effective use require, building a perfect information collection and assessment bureaucracy.

6. Theorising the Capability Approach

A number of philosophers sympathetic to Sen's foundational concerns have nevertheless been dissatisfied with the vagueness and under-elaboration of the theoretical structure of his Capability Approach (although these features seem to be quite deliberate on Sen's part). A number of theoretical accounts have been developed that seek to elaborate the Capability Approach more systematically and to address these philosophers' particular concerns. Some theoretical accounts are primarily concerned with operationalising the evaluative dimension of the Capability Approach: the assessment of quality of life, well-being and human development. Others focus on developing a capability based 'Theory of Justice' in the spirit of its concerns. This section provides a brief outline of some of these.

a. Generating Lists for Empirical Research in the Social Sciences (Ingrid Robeyns)

Ingrid Robeyns argues that attempting to develop a single all-purpose list of capabilities would be incompatible with Sen's concern with a general framework of evaluation. Instead she proposes a procedural approach to the selection of capabilities for particular purposes, such as the evaluation of gender inequality in terms of capabilities (Robeyns 2003). She claims that valuational procedures that meet her criteria provide epistemic, academic, and political legitimacy for empirically evaluating capability. Her five criteria are:

(1) *Explicit formulation.* All proposed list elements should be explicit, so they can be discussed and debated.

(2) *Methodological justification*. The method of generating the list should be made explicit so it can be scrutinized.

(3) *Sensitivity to context*. The level of abstraction of the list should be appropriate to its purposes, whether for philosophical, legal, political, or social discussion.

(4) *Different levels of generality*. If the list is intended for empirical application or public policy then it should be drawn up in two distinct stages, first an ideal stage and then a pragmatic one that reflects perhaps temporary feasibility constraints on information and resources.

(5) *Exhaustion and non-reduction.* The list should include all important elements and those elements should not be reducible to others (though they may overlap).

b. A Participatory Approach to Evaluating Capability Expansion (Sabina Alkire)

Sabina Alkire has developed a philosophically grounded framework for the participatory valuation and evaluation of development projects in terms of capability enhancement (Alkire 2005). This allows her to go beyond standard cost-benefit analyses of development projects in financial terms to investigate which capabilities that the people concerned have reason to value are enhanced and by how much.

Alkire's approach has 2 stages of evaluation: i) a theoretical one-off stage in which 'philosophers' employ practical reason to reflexively identify the basic spheres or categories of value, and ii) a local participatory phase in which members of a social group deliberate, with the aid of a facilitator, about what their needs are and what, and how, they would like to do about them (with the basic categories employed as prompts to ensure that all main dimensions of value are discussed). For the first, philosophical, stage Alkire proposes an adaptation of the practical reasoning approach of John Finnis to identify the basic dimensions of human well-being by asking iteratively, 'why do I/others do what we do?' until one comes to recognize the basic reasons for which no further reasoned justification can be given. This method is intended to yield substantive and objective descriptions of the fundamental, non-hierarchically ordered, dimensions of human flourishing, while allowing the content and relative importance of these dimensions to be specified in a participatory process according to a particular group's historical, cultural, and personal values. The intrinsically important dimensions identified by this method are: *Life; Knowledge; Play; Aesthetic experience; Sociability; Practical reasonableness; Religion*.

One of the advantages Alkire claims for her approach is its ability to elicit what the people whose lives are the subject of development projects really consider valuable, which may sometimes surprise external planners and observers. Her use of the participatory approach for assessing NGO fieldwork in Pakistan showed, for example, that even the very poor can and do reasonably value other things than material well-being, such as religion and social participation.

c. Justice as Equal Capability of Democratic Citizenship (Elizabeth Anderson)

Elizabeth Anderson has proposed a partial theory of justice based on equal capability of democratic citizenship (Anderson 1999). Anderson takes equality in social relationships as the focus for her egalitarian theory of justice and argues that one should analyze the requirements of such equality in terms of the social conditions supporting it as a capability. Although Anderson's primary concern is for equality in the particular dimension of democratic citizenship, she suggests that this has extensive egalitarian implications for the nature of the society as a whole, because other capabilities – such as relating to health, education, personal autonomy and self-respect, and economic fairness – are required as supporting conditions to realize truly equal citizenship. She argues that, "Negatively, people are entitled to whatever capabilities are necessary to enable them to avoid or escape entanglement in oppressive social relationships. Positively, they are entitled to whatever capabilities are necessary for functioning as an equal citizen in a democratic state (Anderson 1999, 317)."

d. Capability as Freedom from Domination (John Alexander)

John Alexander has proposed a capability theory based on a Republican understanding of the importance of freedom as non-domination (Alexander 2008). He argues that the Capability Approach's concern with people's 'real freedom' sets it outside and against the standard liberal egalitarian theory of justice framework which understands freedom as the absence of constraints. But he argues that the Capability Approach should go further to elaborate this commitment to real freedom in Republican terms. In this perspective it is not only important that one be able to achieve certain functionings, such as mobility, but whether one's achievement of these are conditional on the favor or goodwill of other people or are independently guaranteed by one's own rights and powers. Capability is standardly understood as mapping one's range of choices over valuable functionings regardless of their *content*. For example, the ability of a physically disabled but socially well-connected person to travel outside whenever she wants by arranging the help of friends, family and voluntary organizations. In addition the Republican perspective requires that her capability for mobility should be independent of *context*. For example, in the form of a guaranteed legal right to government assistance on demand, or by the provision of her own specially adapted self-drive vehicle. Otherwise she may be said to be still deprived since her capability is not completely free.

Domination should also be integrated into capability evaluation because it will often be a *cause* of capability deprivation. It is no coincidence that the people who are most capability deprived are often the poorest and weakest in society, and as a result also vulnerable to yet further exploitation. This emphasis on freedom from domination also gives a strong normative orientation to the Capability Approach's evaluation of the causes of capability failure: some causes are simply unacceptable, such as social norms restricting women's freedom of movement and employment, and should be removed rather than mitigated.

7. Martha Nussbaum's Capability Theory of Justice

This section outlines Martha Nussbaum's work on the Capability Approach: its structure, criticisms, and relationship to Amartya Sen's work.

a. Structure and Development of Nussbaum's Capability Theory

Martha Nussbaum has developed the most systematic, extensive, and influential capability theory of justice to date. Nussbaum aims to provide a partial theory of justice (one that doesn't exhaust the requirements of justice) based on *dignity*, a *list of fundamental capabilities*, and a *threshold*.

Nussbaum's list of The Central Human Capabilities (Reproduced from Creating Capabilities 2011, 33-4)

1. *Life.* Being able to live to the end of a human life of normal length; not dying prematurely, or before one's life is so reduced as to be not worth living.

2. *Bodily Health.* Being able to have good health, including reproductive health; to be adequately nourished; to have adequate shelter.

3. *Bodily Integrity*. Being able to move freely from place to place; to be secure against violent assault, including sexual assault and domestic violence; having opportunities for sexual satisfaction and for choice in matters of reproduction.

4. *Senses, Imagination, and Thought.* Being able to use the senses, to imagine, think, and reason – and to do these things in a ''truly human'' way, a way informed and cultivated by an adequate education, including, but by no means limited to, literacy and basic mathematical and scientific training. Being able to use imagination and thought in connection with experiencing and producing works and events of one's own choice, religious, literary, musical, and so forth. Being able to use one's mind in ways protected by guarantees of freedom of expression with respect to both political and artistic speech, and freedom of religious exercise. Being able to have pleasurable experiences and to avoid non-beneficial pain.

5. *Emotions.* Being able to have attachments to things and people outside ourselves; to love those who love and care for us, to grieve at their absence; in general, to love, to grieve, to experience longing, gratitude, and justified anger. Not having one's emotional development blighted by fear and anxiety. (Supporting this capability means supporting forms of human association that can be shown to be crucial in their development.)

6. *Practical Reason.* Being able to form a conception of the good and to engage in critical reflection about the planning of one's life. (This entails protection for the liberty of conscience and religious observance.)

7. *Affiliation.*

A. Being able to live with and toward others, to recognize and show concern for other human beings, to engage in various forms of social interaction; to be able to imagine the situation of another. (Protecting this capability means protecting institutions that constitute and nourish such forms of affiliation, and also protecting the freedom of assembly and political speech.)

B. Having the social bases of self-respect and nonhumiliation; being able to be treated as a dignified being whose worth is equal to that of others. This entails provisions of nondiscrimination on the basis of race, sex, sexual orientation, ethnicity, caste, religion, national origin.

8. Other Species. Being able to live with concern for and in relation to animals, plants, and the world of nature.

9. *Play*. Being able to laugh, to play, to enjoy recreational activities.

10. *Control Over One's Environment.*

A. Political. Being able to participate effectively in political choices that govern one's life; having the right of political participation, protections of free speech and association.

B. Material. Being able to hold property (both land and movable goods), and having property rights on an equal basis with others; having the right to seek employment on an equal basis with others; having the freedom from unwarranted search and seizure. In work, being able to work as a human being, exercising practical reason, and entering into meaningful relationships of mutual recognition with other workers.

In her early contributions to the capability approach, Nussbaum justified the composition of her list by explicitly Aristotelian argument about the perfectionist requirements of the truly human life (Nussbaum 1988). In the mid-1990s however she converted the structure of her account to a Rawlsian style 'politically liberal' account. This means that she now presents her list as a proposal that is neutral with respect to particular conceptions of the good, but can be endorsed by many different groups in a society through an overlapping consensus. However the list components themselves remain almost identical and retain a distinctively Aristotelian cast.

THE STRUCTURAL CHARACTERISTICS OF DEVELOPING ECONOMY

Developing economies are characterized by low per capita income, high population growth, dependence on primary sectors, and limited infrastructure, often leading to high poverty and unemployment rates.

Economic Characteristics:

1. **Low Per Capita Income:** Developing countries typically have significantly lower average incomes compared to developed nations.
2. **High Population Growth:** Rapid population growth can strain resources and infrastructure, hindering economic development.
3. **Dependence on Primary Sectors:** A large portion of the workforce and economic activity is concentrated in agriculture and resource extraction, which are often less productive and have lower value-added.
4. **Low Levels of Capital Formation:** Developing economies often struggle to accumulate sufficient capital for investment in infrastructure, technology, and human capital.

5. **High Unemployment and Underemployment:** Unemployment and underemployment are common, reflecting a mismatch between the skills of the workforce and the available jobs.
6. **Inequality in Income Distribution:** Income and wealth are often unevenly distributed, leading to large disparities between the rich and poor.
7. **Poor Infrastructure:** Inadequate infrastructure, such as roads, power grids, and telecommunications, can hinder economic activity and development.
8. **Limited Human Capital:** Low levels of education, healthcare, and skills training can limit the productivity and competitiveness of the workforce.
9. **Dependence on Exports of Primary Commodities:** Developing economies often rely on exporting raw materials and agricultural products, which are subject to price fluctuations and may not generate high value.
10. **Dualistic Economy:** The existence of both a modern, advanced sector and a traditional, underdeveloped sector can create structural imbalances.

Social and Demographic Characteristics:

1. **High Poverty Rates:** A large proportion of the population lives below the poverty line, lacking access to basic necessities.
2. **High Mortality Rates:** Developing countries often have higher infant and maternal mortality rates, reflecting poor healthcare and living conditions.
3. **Low Levels of Education:** Access to quality education is limited, particularly in rural areas, which can limit opportunities for social and economic mobility.
4. **Health Challenges:** Developing countries often face challenges related to infectious diseases, malnutrition, and lack of access to healthcare.
5. **Political Instability:** Political instability, corruption, and weak governance can hinder economic development and create uncertainty for investors.
6. **Environmental Degradation:** Rapid industrialization and resource exploitation can lead to environmental problems, such as pollution and deforestation.

FACTORS OF DEVELOPMENT

Development, whether individual or societal, is influenced by a complex interplay of factors, including genetics, environment, access to resources, education, healthcare, and social dynamics.

Individual Development:

1. **Genetics:** Inherited traits and predispositions play a role in an individual's potential for growth and development.
2. **Environment:** The physical surroundings, social interactions, and cultural context significantly impact development.
3. **Nutrition:** Adequate and balanced nutrition is crucial for physical and cognitive development, especially in childhood.
4. **Healthcare:** Access to quality healthcare, including vaccinations and medical care, is essential for preventing diseases and promoting well-being.
5. **Education:** Access to quality education and learning opportunities is vital for cognitive development, skill acquisition, and future success.
6. **Family and Social Life:** Strong family relationships, supportive social networks, and positive social interactions contribute to emotional and social development.
7. **Psychological Factors:** Mental and emotional well-being, including factors like stress, trauma, and mental health, can significantly impact development.

Societal Development:

1. **Economic Factors:** Economic growth, access to resources, and infrastructure development are crucial for overall societal progress.

2. **Political Stability and Governance:** Stable and effective governance, along with the rule of law, are essential for creating a conducive environment for development.
3. **Social Cohesion:** A society characterized by mutual respect, tolerance, and inclusivity fosters stability and progress.
4. **Technological Advancement:** Technological innovation and adoption can drive economic growth and improve living standards.
5. **Education and Human Capital:** Investing in education and developing a skilled workforce is vital for long-term economic and social progress.
6. **Natural Resources:** Access to and sustainable management of natural resources are important for economic development and environmental sustainability.
7. **Infrastructure:** Adequate infrastructure, including transportation, communication, and energy, is essential for economic activity and social development.
8. **Population Dynamics:** Population size, growth rate, and distribution can impact development, requiring careful planning and resource management.

FACTORS INFLUENCING CAPITAL ACCUMULATION

Capital accumulation, crucial for economic development, is influenced by factors like savings, investment, technological advancements, and a skilled workforce, all of which contribute to increased productivity and economic growth.

1. Savings and Investment:

- **Savings:** A higher savings rate allows for more investment in capital goods, leading to increased production capacity and economic growth.
- **Investment:** Direct investment in tangible assets like machinery and infrastructure, as well as financial investments, are key drivers of capital accumulation.

2. Technological Advancements:

- **Innovation:** Technological breakthroughs can significantly boost productivity and efficiency, leading to higher output and increased capital returns.
- **Research and Development:** Investments in research and development are essential for fostering innovation and creating new technologies that drive economic growth.

3. Human Capital:

- **Skilled Workforce:** A well-educated and skilled workforce is crucial for effectively utilizing capital and driving innovation.
- **Education and Training:** Investments in education and training programs can enhance the skills and capabilities of the workforce, leading to higher productivity and economic growth.

4. Economic and Political Stability:

- **Stable Macroeconomic Environment:** A stable macroeconomic environment, characterized by low inflation and predictable policies, encourages investment and capital accumulation.
- **Good Governance:** Effective governance, including the rule of law and protection of property rights, creates a conducive environment for investment and economic growth.

5. Natural Resources:

- **Resource Abundance:** Abundant natural resources can provide a foundation for economic growth, but their effective management and utilization are crucial.
- **Resource Management:** Sustainable resource management practices are essential for ensuring long-term economic growth and development.

6. Foreign Direct Investment (FDI):

- **Capital Inflow:** FDI can bring in capital, technology, and expertise, contributing to capital accumulation and economic growth.
- **Infrastructure Development:** FDI can also lead to investments in infrastructure, which is essential for economic development.

The key factors of development related to labor include land, labor itself (human effort), capital (tools, equipment), and entrepreneurship (innovation and risk-taking), all of which are crucial for producing goods and services and driving economic growth.

- **Land:** This refers to natural resources and physical space used in production, including land for agriculture, mining, and construction.
- **Labor:** This encompasses all human effort, both physical and mental, used in the production process. It includes the skills, knowledge, and abilities of the workforce.
- **Capital:** This refers to man-made resources used in production, such as machinery, tools, equipment, and infrastructure.
- **Entrepreneurship:** This involves the ability to identify opportunities, take risks, and organize resources to create new products, services, or processes.

These four factors are interconnected and work together to drive economic development by enabling the production of goods and services, creating jobs, and fostering innovation.

THE ROLE OF NATURAL RESOURCES IN DEVELOPMENT

Natural resources are a crucial factor in development, influencing economic growth, living standards, and sustainable livelihoods, but their availability and sustainable use depend on various factors like technology, capital, and policies.

1. Importance of Natural Resources:

A. **Economic Growth:** Natural resources like minerals, land, water, and forests are essential inputs for production, contributing to economic growth and increased living standards.

B. **Foreign Exchange:** The export of natural resources can generate foreign exchange, which can be used to import capital goods and technology, further boosting development.

C. **Sustainable Livelihoods:** Natural resources are vital for food security, clean water, and a healthy environment, all of which are essential for sustainable livelihoods.

D. **Capital Formation:** The exploitation and processing of natural resources can lead to capital accumulation, which is crucial for further investment and development.

2. Factors Influencing the Role of Natural Resources:

A. **Technology:** Technological advancements are crucial for efficiently extracting, processing, and utilizing natural resources.

B. **Capital:** Investment in infrastructure, machinery, and skilled labor is essential for developing and managing natural resources effectively.

C. **Labor:** A skilled and available workforce is needed to operate industries that rely on natural resources.

D. **Policies and Governance:** Sound policies and effective governance are crucial for sustainable resource management, preventing overexploitation, and ensuring equitable distribution of benefits.

E. **Environmental Factors:** Climate, geography, and biodiversity play a vital role in the availability and sustainability of natural resources.

F. **Social and Political Factors:** Social structures, political stability, and access to resources can influence how natural resources are used and managed.

3. Challenges and Considerations:

A. **Depletion and Degradation:** Unsustainable resource extraction and pollution can lead to the depletion and degradation of natural resources, undermining long-term development.

B. **Unequal Distribution:** Natural resources are often unevenly distributed, leading to disparities in development and potential conflicts.

C. **Environmental Impacts:** Development activities that rely heavily on natural resources can have significant environmental impacts, including deforestation, pollution, and climate change.

D. **Social Inequalities:** The benefits of resource extraction and development are not always shared equitably, leading to social inequalities and conflicts.

E. **Resource Curse:** Some countries rich in natural resources have experienced economic stagnation or even decline due to mismanagement of resources and corruption.

THE FACTORS THAT CONTRIBUTE TO TECHNOLOGICAL PROGRESS

Technological progress, a key driver of economic development, is influenced by factors like innovation, research and development, infrastructure, education, and economic resources, as well as the demand for new technologies and a supportive regulatory framework.

1. Innovation and Research & Development (R&D):

- **Innovation:** The creation and implementation of new ideas, products, processes, or services are crucial for driving technological advancement.
- **R&D:** Investment in research and development plays a vital role in fostering technological breakthroughs and improvements.
- **Examples:** New technologies like AI, machine learning, and robotics are constantly emerging as a result of R&D efforts.

2. Economic Factors:

- **Economic Resources:** The availability of financial resources is essential for funding research, development, and the deployment of new technologies.
- **Capital Formation:** Investment in infrastructure, machinery, and other capital assets is vital for supporting technological progress.
- **Economic Growth:** Technological progress often leads to increased productivity and economic growth, creating a virtuous cycle.

3. Infrastructure and Education:

- **Infrastructure:** A well-developed infrastructure, including transportation, communication, and energy networks, is crucial for supporting technological development and deployment.
- **Education:** A skilled workforce with the necessary knowledge and abilities is essential for developing and implementing new technologies.
- **Examples:** Strong educational institutions and training programs can help build a skilled workforce capable of innovation and technological advancement.

4. Demand and Competition:

- **Consumer Demand:** The needs and expectations of consumers can drive the development of new technologies that meet their needs and improve their lives.
- **Market Competition:** Competition among businesses can spur innovation and the development of more efficient and effective technologies.
- **Examples:** The rise of e-commerce and mobile technologies is a result of both consumer demand and competition among businesses.

5. Regulatory Framework:

- **Government Policies:** Government policies and regulations can play a significant role in shaping technological development by providing incentives for innovation and setting standards for safety and performance.

- **Examples:** Government funding for research and development, intellectual property protection, and regulations related to new technologies can all influence technological progress.

SOCIAL INSTITUTINS CULTURAL VALUES AND ENTREPRENEURIAL ABILITY

Development, driven by factors like social institutions, cultural values, and entrepreneurial ability, is a complex process where strong institutions, shared values, and a proactive entrepreneurial spirit are crucial for fostering economic growth and societal progress.

1. Social Institutions:

Definition:

These are the formal and informal rules, norms, and structures that govern social interactions and behaviors within a society.

Examples:

Legal systems, educational systems, political systems, family structures, and religious institutions.

Impact on Development:

- **Strong institutions**: provide stability, predictability, and a framework for economic activity, encouraging investment and innovation.
- **Weak or corrupt institutions**: can hinder development by creating uncertainty, inequality, and a lack of trust, leading to instability and reduced economic opportunities.
- **Examples:** A functioning legal system that protects property rights and enforces contracts is vital for economic activity.
- **Education and training**: are also crucial social institutions that equip individuals with the skills and knowledge needed for economic participation.

2. Cultural Values:

Definition:

These are the shared beliefs, attitudes, and values that shape a society's norms, behaviors, and traditions.

Examples:

Emphasis on individualism vs. collectivism, risk-taking vs. risk-aversion, hard work vs. leisure, and respect for authority vs. equality.

Impact on Development:

- **Cultural values**: can influence entrepreneurial behavior, investment decisions, and innovation.
- **A culture that values innovation and risk-taking**: can foster entrepreneurship and economic growth.
- **Conversely, a culture that is risk-averse or resistant to change**: can hinder development.
- **Examples:** A culture that values education and hard work can lead to a skilled workforce and economic growth.
- **Examples:** A culture that values social harmony and cooperation can lead to greater social cohesion and stability.

3. Entrepreneurial Ability:

Definition:

This refers to the capacity to identify opportunities, take calculated risks, and create value through innovation and resourcefulness.

Characteristics of Entrepreneurs:

Visionary, creative, confident, opportunity seekers, risk-takers, and relation builders.

Impact on Development:

- **Entrepreneurs**: are key drivers of economic growth, job creation, and innovation.

- **They create new businesses, introduce new products and services, and adapt to changing market conditions** .
- **Entrepreneurship can also lead to social innovation and improvements in quality of life** .
- **Examples:** Entrepreneurs can develop new technologies, create new industries, and address social problems.
- **Examples:** Entrepreneurs can create jobs, generate wealth, and improve living standards.

UNIT - II

THEORIES OF ECONOMIC GROWTH

Economic growth is the process whereby the real per capita income of a country increases over a long period of time. Several factors contribute to economic growth of a country. Growth of population, particularly working population, is the first cause of growth. Technical knowledge and progress are the twin factors in increasing the output per head. Growth in the quantity of capital per head is another factor, which tends to raise the growth rate of the economy. Supply of savings is another factor that determines the rate of growth of an economy. Structural transformation also leads to economic growth. Urbanization is another factor promising economic growth. Another factor, which leads to economic growth is growth of foreign trade.

Economic Growth vs. Economic Development

A clear distinction has to be made between the two terms, 'Economic Growth' and 'Economic Development'. Economic growth is related to a quantitative and sustained increase in the country's per capita output or income accompanied by expansion in its labour force, consumption, capital and volume of trade. On the other hand, economic development is a wider term. It is related to qualitative changes in the entire social system i.e., economic wants, goods, incentives and institutions, productivity, etc. It describes the underlying determinants of growth such as technological and structural changes. 9 Economic growth is a necessary but not sufficient condition for economic development. Compared to the objective of development, economic growth is far easier to realise. This is because the process of development is far more pervasive. Apart from a rise in output, it involves changes in the composition of output as well as a shift in the allocation of productive resources so as to ensure social justice. Thus, an economy can grow, but it may not develop because poverty, unemployment and inequalities may continue to persist due to the absence of technological and structural changes. But it is difficult to imagine development without economic growth. Despite these apparent differences, some economists use the terms as synonyms.

HARROD–DOMAR MODEL

The **Harrod–Domar model** is a Keynesian model of economic growth. It is used in development economics to explain an economy's growth rate in terms of the level of saving and of capital. It suggests that there is no natural reason for an economy to have balanced growth. The model was developed independently by Roy F. Harrod in 1939, and Evsey Domar in 1946, although a similar model had been proposed by Gustav Cassel in 1924. The Harrod–Domar model was the precursor to the exogenous growth model.

Neoclassical economists claimed shortcomings in the Harrod–Domar model—in particular the instability of its solution —and, by the late 1950s, started an academic dialogue that led to the development of the Solow–Swan model.

According to the Harrod–Domar model there are three kinds of growth: warranted growth, actual growth and natural rate of growth.

Warranted growth rate is the rate of growth at which the economy does not expand indefinitely or go into recession. Actual growth is the real rate increase in a country's GDP per year. (See also: Gross domestic product and Natural gross domestic product). Natural growth is the growth an economy requires to maintain full employment. For example, If the labor force grows at 3 percent per year, then to maintain full employment, the economy's annual growth rate must be 3 percent

Let Y represent output, which equals income, and let K equal the capital stock. S is total saving, s is the savings rate, and I is investment. δ stands for the rate of depreciation of the capital stock. The Harrod–Domar model makes the following *a priori* assumptions:

1: Output is a function of capital stock only (labor is irrelevant).

2: The marginal product of capital is constant; the production function exhibits constant returns to scale. This implies capital's marginal and average products are equal.

3: Capital is necessary for output.

4: The product of the savings rate and output equals saving, which equals investment

5: The change in the capital stock equals investment less the depreciation of the capital stock

Significance

Domar proposed the model in the aftermath of the great depression, intending to model economies in the short-run, during a period where there is high enough unemployment such that any additional machine may be fully utilized by labor. Consequently, production can be modelled as a function of capital only.[8]

Although the Harrod–Domar model was initially created to help analyse the business cycle, it was later adapted to explain economic growth. Its implications were that growth depends on the quantity of labour and capital; more investment leads to capital accumulation, which generates economic growth. The model carries implications for less economically developed countries, where labour is in plentiful supply in these countries but physical capital is not, slowing down economic progress. LDCs do not have sufficiently high incomes to enable sufficient rates of saving; therefore, accumulation of physical-capital stock through investment is low.

The model implies that economic growth depends on policies to increase investment, by increasing saving, and using that investment more efficiently through technological advances.

The model concludes that an economy does not "naturally" find full employment and stable growth rates.

Criticisms

The main criticism of the model is the level of assumption, one being that there is no reason for growth to be sufficient to maintain full employment; this is based on the belief that the relative price of labour and capital is fixed, and that they are used in equal proportions. The model also assumes that savings rates are constant, which may not be true, and assumes that the marginal returns to capital are constant. Furthermore, the model has been criticized for the assumption that productive capacity is proportional to capital stock, which Domar later stated was not a realistic assumption

ROSTOW'S STAGES OF GROWTH

The **Rostovian take-off model** (also called "Rostow's Stages of Growth") is one of the major historical models of economic growth. It was developed by W. W. Rostow. The model postulates that economic modernization occurs in five basic stages, of varying length.

1. Traditional society
2. Preconditions for take-off
3. Take-off
4. Drive to maturity
5. Age of High mass consumption

Rostow asserts that countries go through each of these stages fairly linearly, and set out a number of conditions that were likely to occur in investment, consumption and social trends at each state. Not all of the conditions were certain to occur at each stage, however, and the stages and transition periods may occur at varying lengths from country to country, and even from region to region.

Rostow's model is one of the more structuralist models of economic growth, particularly in comparison with the 'backwardness' model developed by Alexander Gerschenkron. The two models are not necessarily mutually exclusive, however, and many countries seem to follow both models rather adequately.

Beyond the structured picture of growth itself, another important part of the model is that economic take-off must initially be led by a few individual sectors. This belief echoes David Ricardo's comparative advantage thesis and criticizes Marxist revolutionaries push for economic self-reliance in that it pushes for the 'initial' development of only one or two sectors over the development of all sectors equally. This became one of the important concepts in the theory of modernization in the social evolutionism.

Theoretical Framework

Rostow's model is descendent from the liberal school of economics, emphasizing the efficacy of modern concepts of free trade and the ideas of Adam Smith. It also denies Friedrich List's argument that countries reliant on exporting raw materials may get "locked in", and be unable to diversify, in that Rostow's model states that countries may need to depend on a few raw material exports to finance the development of manufacturing sectors which are not yet of superior competitiveness in the early stages of take-off. In that way, Rostow's model does not deny John Maynard Keynes in that it allows for a degree of government control over domestic development not generally accepted by some ardent free trade advocates. Although empirical at times, Rostow is hardly free of normative discourse. As a basic assumption, Rostow believes that countries want to modernize as he describes modernization, and that society will assent to the materialistic norms of economic growth.

STAGES

Traditional Societies

Traditional societies are marked by their pre-Newtonian understanding and use of technology. These are societies which have pre-scientific understandings of gadgets, agriculture is predominant and society has a hierarchical structure. The norms of economic growth are completely absent from these societies.The society has a low ceiling on per capita output because of the backwardness of the technology. Agriculture is the main source of income.

Preconditions to Take-off

The preconditions to take-off according to Rostow, refers to that the society begins committing itself to secular education, that it enables a degree of capital mobilization, especially through the establishment of banks and currency, that an entrepreneurial class forms, and that the secular concept of manufacturing develops, with only a few sectors developing at this point. This leads to a take-off in ten to fifty years. At this stage, there is a limited production function, and therefore a limited output.

Take-off

Take-off then occurs when sector led growth becomes common and society is driven more by economic processes than traditions. At this point, the norms of economic growth are well established. In discussing the take-off, Rostow is a noted early adopter of the term “transition”, which is to describe the passage of a traditional to a modern economy. After take-off, a country will take as long as fifty to one hundred years to reach maturity. Globally, this stage occurred during the Industrial Revolution in economic development.

Conditions for Take-off

The requirements of take-off are the following two related but necessary conditions:

1. A rise in the rate of productive investment from approximately 10% or less to over 20% of national income or net national product;
2. The development of one or more substantial manufacturing sectors with a high rate of growth; he indicates the leading sectors in the economy. Rostow regards the development of leading sectors as the 'analytical bone structure' of the stages of economic growth.

There are generally three sectors of an economy:

1. Primary Sector - Agriculture
2. Secondary Sector - Manufacturing
3. Tertiary Sector - Services

Drive to Maturity

After take-off, there follows a long interval of sustained, if fluctuating, progress, as the now regularly growing economy drives to extend modern technology over the whole front of its economic activity. Some 10-20% of the national income is steadily invested, permitting output regularly to outstrip the increase in population. The makeup of the economy changes unceasingly as technique improves, new industries accelerate, and older industries level off. The economy finds its place in the international economy: goods formerly imported are produced at home; new import requirements develop, and new export commodities match them. Society makes such terms as it will with the requirements of modern efficient production, balancing off the new against the older values and institutions, or revising the latter in such ways as to support rather than to retard the growth process. The drive to maturity refers to the need for the economy to diversify. The sectors of the economy which lead initially begin to level off, while other sectors begin to take off. This diversity leads to greatly reduced rates of poverty and rising standards of living, as a society no longer needs to sacrifice its comfort in order to strengthen certain sectors.

Age of High Mass Consumption

The age of high mass consumption refers to the period of contemporary comfort afforded many western nations, wherein consumers concentrate on durable goods, and hardly remember the subsistence concerns of previous stages. Rostow uses the Buddenbrooks dynamics metaphor to describe this change in attitude. In Thomas Mann’s novel *Buddenbrooks,* a family is chronicled for three generations. The first generation is interested in economic development, the second in its position in society. The third, already having money and prestige, concerns itself with the arts and music, worrying little about those previous, earthly concerns. So too, in the age of high mass consumption, a society is able to choose between concentrating on military and security issues, on equality and welfare issues, or on developing great luxuries for its upper class. Each country in this position chooses its own balance between these three goals.

Of particular note is the fact that Rostow's "Age of High Mass Consumption" dovetails with (occurring before) Daniel Bell's hypothesized "Post-Industrial Society." The Bell and Rostovian models collectively suggest that economic maturation inevitably brings on job-growth which can be followed by wage escalation in the secondary economic sector (manufacturing), which is then followed by dramatic growth in the tertiary economic sector (commerce and services). In the Bell model, the tertiary economic sector rises to predominance, encompassing perhaps 65 to 75 percent of the employment in a given economy. Maturation can then bring-on deindustrialization as manufacturers reorient to cheaper labor markets, and deindustrialization can, in turn, destabilize the tertiary sector. The suggestion is that mature economies may implicitly destabilize and cycle back-and-forth between the final stages of the Rostovian-Bell developmental phases as they rebalance themselves, over time, and re-evolve their economic base.

Criticism of the Model

1: Rostow is **historical** in the sense that the result is known at the outset and is derived from the historical geography of a developed, bureaucratic society.

2: Rostow is **mechanical** in the sense that the underlying motor of change is not disclosed and therefore the stages become little more than a classificatory system based on data from developed countries.

3: His model is based on American and European history and defines the American norm of high mass consumption as integral to the economic development process of all industrialized societies.

4: His model assumes the inevitable adoption of Neoliberal trade policies which allow the manufacturing base of a given advanced polity to be relocated to lower-wage regions.

Rostow's thesis is biased towards a western model of modernization, but at the time of Rostow the world's only mature economies were in the west, and no controlled economies were in the "era of high mass consumption." The model de-emphasizes differences between sectors in capitalistic vs. communistic societies, but seems to innately recognize that modernization can be achieved in different ways in different types of economies.

The most disabling assumption that Rostow is accused of is trying to fit economic progress into a linear system. This charge is correct in that many countries make false starts, reach a degree of transition and then slip back, or as is the case in contemporary Russia, slip back from high mass consumption (or almost) to a country in transition. On the other hand, Rostow's analysis seems to emphasize success because it is trying to explain success. To Rostow, if a country can be a disciplined, uncorrupt investor in itself, can establish certain norms into its society and polity, and can identify sectors where it has some sort of advantage, it can enter into transition and eventually reach modernity. Rostow would point to a failure in one of these conditions as a cause for non-linearity.

Another problem that Rostow's work has is that it considers mostly large countries: countries with a large population (Japan), with natural resources available at just the right time in its history (Coal in Northern European countries), or with a large land mass (Argentina). He has little to say and indeed offers little hope for small countries, such as Rwanda, which do not have such advantages. Neo-liberal economic theory to Rostow, and many others, does offer hope to much of the world that economic maturity is coming and the age of high mass consumption is nigh. But that does leave a sort of 'grim meathook future' for the outliers, which do not have the resources, political will, or external backing to become competitive

THE "LEWIS MODEL"

Lewis published in 1954 what was to be his most influential development economics article, "Economic Development with Unlimited Supplies of Labour" (Manchester School). In this publication, he introduced what came to be called the dual sector model, or the "Lewis model".

Lewis combined an analysis of the historical experience of developed countries with the central ideas of the classical economists to produce a broad picture of the development process. In his theory, a "capitalist" sector develops by taking labour from a non-capitalist backward "subsistence" sector. The subsistence sector is governed by informal institutions and social norms so that producers do not maximize profits and workers can be paid above their marginal product. At an early stage of development, the "unlimited" supply of labour from the subsistence economy means that the capitalist sector can expand for some time without the need to raise wages. This results in higher returns to capital, which are reinvested in capital accumulation. In turn, the increase in the capital stock leads the "capitalists" to expand employment by drawing further labour from the subsistence sector. Given the assumptions of the model (for example, that the profits are reinvested and that capital accumulation does not substitute for skilled labour in production), the process becomes self-sustaining and leads to modernization and economic development.

The point at which the excess labour in the subsistence sector is fully absorbed into the modern sector, and where further capital accumulation begins to push the balance of power towards labour (thus increasing wages) in both capitalist and subsistence sectors, is sometimes called the Lewisian turning point. It has recently been widely discussed in the context of economic development in China. Work building on Lewis's analysis has shown that productivity gains in the areas formerly occupied by the subsistence sector (e.g. agriculture) can offset some of the labour demand.

The Theory of Economic Growth **(1955)**

In his 1955 book, *The Theory of Economic Growth*, Lewis sought to "provide an appropriate framework for studying economic development", driven by a combination of "curiosity and of practical need."

During the Industrial Revolution, England was experiencing the worst economic turmoil of its time. It would not be until an economic enlightenment took place that cities began to shift towards factories and labour-intensive methods of production as they experienced giant shifts in the labour and agriculture markets, thus, eventually leading to higher production, and higher income. Lewis theorized if England could turn its misfortune around, the same could be done for developing countries around the world. His theories proved true for some countries such as Nigeria and Barbados, as they would see some economic development.

Politics in West Africa **(1965)**

In his 1965 book, *Politics in West Africa*, Lewis examines the weakness of opposition parties in West African states. He criticizes the majoritarian winner-takes-all model of politics, arguing that while it may work in European and American contexts, it cannot in the context of many African states. The reason for this is that African states are divided on linguistic and tribal lines, making it hard for peaceful co-existence between groups when one group controls the central government. Lewis argues powersharing needs to be facilitated, which he argues can be best done through proportional representation, federalism and coalition governments. Democracy can be maintained through institutional design more suited to the cleavages of African states

THE DUAL SECTOR MODEL, or the **Lewis model**, is a model in developmental economics that explains the growth of a developing economy in terms of a labour transition between two sectors, the subsistence or traditional agricultural sector and the capitalist or modern industrial sector.

History

Initially enumerated in an article entitled "Economic Development with Unlimited Supplies of Labor" written in 1954 by Sir Arthur Lewis, the model itself was named in Lewis's honor. First published in *The Manchester School* in May 1954, the article and the subsequent model were instrumental in laying the foundation for the field of Developmental economics. The article itself has been characterized by some as the most influential contribution to the establishment of the discipline.

Theory

The "Dual Sector Model" is a theory of development in which surplus labor from traditional agricultural sector is transferred to the modern industrial sector whose growth over time absorbs the surplus labor, promotes industrialization and stimulates sustained development.

In the model, the traditional agricultural sector is typically characterized by low wages, an abundance of labour, and low productivity through a labour intensive production process. In contrast, the modern manufacturing sector is defined by higher wage rates than the agricultural sector, higher marginal productivity, and a demand for more workers initially. Also, the manufacturing sector is assumed to use a production process that is capital intensive, so investment and capital formation in the manufacturing sector are possible over time as capitalists' profits are reinvested in the capital stock. Improvement in the marginal productivity of labour in the agricultural sector is assumed to be a low priority as the hypothetical developing nation's investment is going towards the physical capital stock in the manufacturing sector.

Since the agricultural sector has a limited amount of land to cultivate, the marginal product of an additional farmer is assumed to be zero as the law of diminishing marginal returns has run its course due to the fixed input, land. As a result, the agricultural sector has a quantity of farm workers that are not contributing to agricultural output since their marginal productivities are zero. This group of farmers that is not producing any output is termed surplus labour since this cohort could be moved to another sector with no effect on agricultural output. (The term surplus labour here is not being used in a Marxist context and only refers to the unproductive workers in the agricultural sector.) Real wages are paid according to: where is total product in the agricultural industry, is the quantity of labor in the agricultural industry and is real wage in the agricultural industry. Therefore, due to the wage differential between the agricultural and manufacturing sectors, workers will tend to transition from the agricultural to the manufacturing sector over time to reap the reward of higher wages.

If a quantity of workers moves from the agricultural to the manufacturing sector equal to the quantity of surplus labour in the agricultural sector, regardless of who actually transfers, general welfare and productivity will improve. Total agricultural product will remain unchanged while total industrial product increases due to the addition of labour, but the additional labour also drives down marginal productivity and wages in the manufacturing sector. Over time as this transition continues to take place and investment results in increases in the capital stock, the marginal productivity of workers in the manufacturing will be driven up by capital formation and driven down by additional workers entering the manufacturing sector. Eventually, the wage rates of the agricultural and manufacturing sectors will equalise as workers leave the agriculture sector for the manufacturing sector, increasing marginal productivity and wages in agriculture whilst driving down productivity and wages in manufacturing.

The end result of this transition process is that the agricultural wage equals the manufacturing wage, the agricultural marginal product of labour equals the manufacturing marginal product of labour, and no further manufacturing sector enlargement takes place as workers no longer have a monetary incentive to transition.

Turning point

The Lewisian "turning point" is the point where the surplus labour pool is depleted. The economy then begins to resemble a developed economy.

Criticism

The theory is complicated by the fact that surplus labour is both generated by the introduction of new productivity enhancing technologies in the agricultural sector and the intensification of work.

The wage differential between industry and agriculture needs to be sufficient to incentivise movement between the sectors and, whereas the model assumes any differential will result in a transfer.

The model assumes rationality, perfect information and unlimited capital formation in industry. These do not exist in practical situations and so the full extent of the model is rarely realised. However, the model does provide a good general theory on labour transitioning in developing economies.

Practical Application

This model has been employed quite successfully in Singapore and helps explain the rapid growth in countries like the UK during the industrial revolution.

RAGNAR NURKSE'S BALANCED GROWTH THEORY

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

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

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

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

Size of market and inducement to invest

The size of a market assumes primary importance in the study of what induces investment in a country. Ragnar Nurkse referenced the work of Allyn A. Young to assert that inducement to invest is limited by the size of the market. The original idea behind this was put forward by Adam Smith, who stated that division of labour (as against inducement to invest) is limited by the extent of the market.

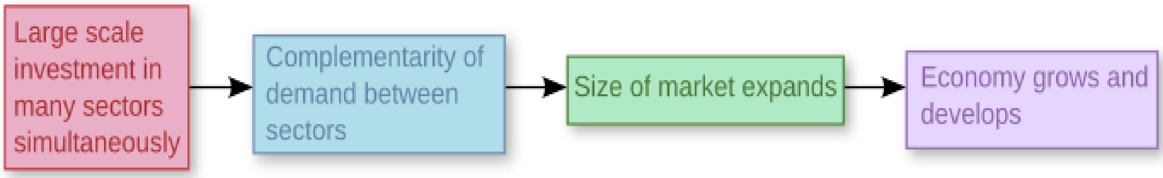
According to Nurkse, underdeveloped countries lack adequate purchasing power. *Low purchasing power* means that the real income of the people is low, although in monetary terms it may be high. If the money income were low, the problem could easily be overcome by expanding the money supply; however, since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

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

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

Ragnar Nurkse concluded,

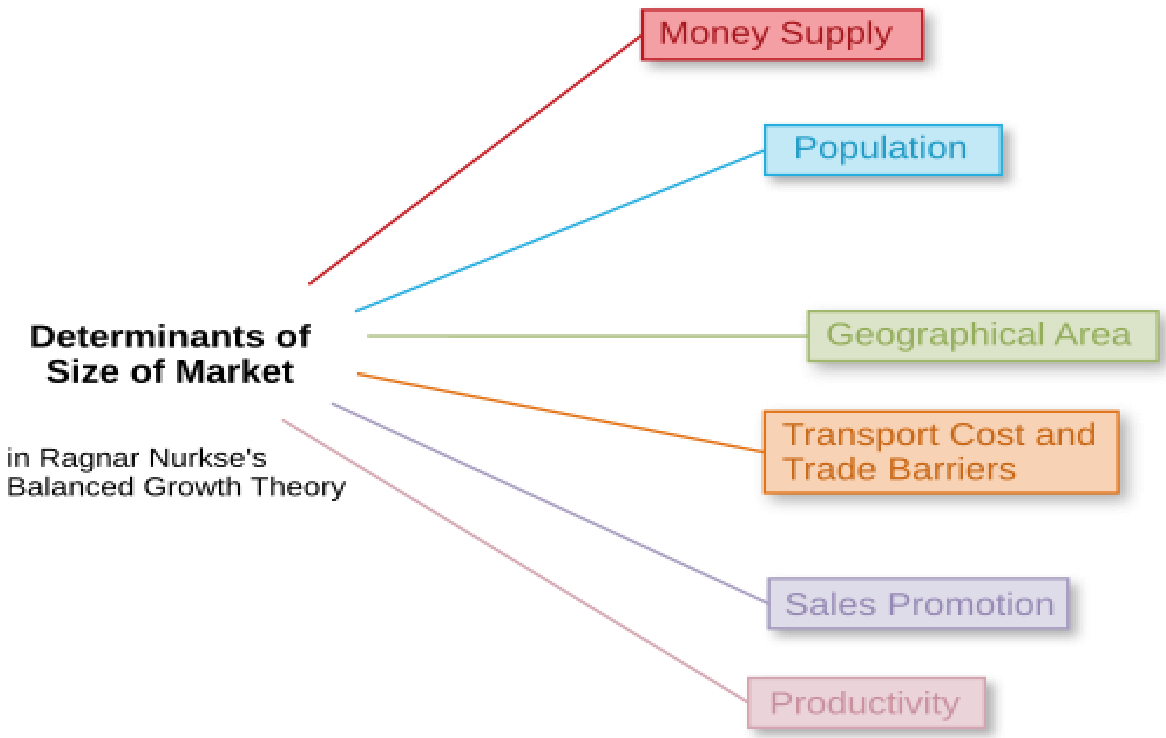
"The limited size of the domestic market in a low income country can thus constitute an obstacle to the application of capital by any individual firm or industry working for the market. In this sense the small domestic market is an obstacle to development generally."



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

Determinants of size of market

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



Money supply

Nurkse emphasised that Keynesian theory shouldn't be applied to underdeveloped countries because they don't face a lack of effective demand in the way that developed countries do.[7] Their problem is to do with a lack of real purchasing power due to low productivity levels. Thus, merely increasing the supply of money will not expand the market but will in fact cause *inflationary pressure*.

Population

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

Geographical area

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

Transport cost and trade barriers

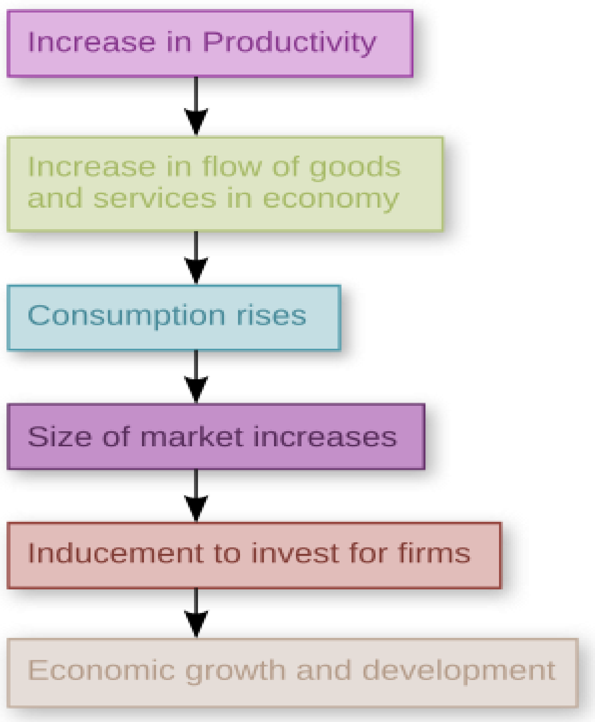
The notion that transport costs and trade barriers hinder the expansion of the market is age-old. Nurkse emphasised that tariff duties, exchange controls, import quotas and other non-tariff barriers to trade are major obstacles to promoting international cooperation in exporting and importing. More specifically, due to high transport costs between nations, producers do not have an incentive to export their commodities. As a result, the amount of capital accumulation remains small. To address this problem, the United Nations produced a report in 1951[10] with solutions for underdeveloped countries. They suggested that they can expand their markets by forming customs unions with neighbouring countries. Also, they can adopt the system of preferential taxation or even abolish customs duties altogether. The logic was that once customs duties are removed, transport costs will fall. Consequently, prices will fall and thus the demand will rise. However, Nurkse, as an export pessimist, did not agree with this view. Export pessimism is a trade theory which is governed by the idea of "inward looking growth" as opposed to "outward looking growth". (See Import substitution industrialization)

Sales promotion

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

Productivity

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



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

For example, in most underdeveloped economies, the *technology* used to carry out agricultural activities is backward. There is a low degree of mechanisation coupled with rain dependence. So while a large proportion of the population (70–80%) may be actively employed in the agriculture sector, the contribution to the Gross Domestic Product may be as low as 40%.[7] This points to the need to increase output per unit input and *output per head*. This can be done if the government provides irrigation facilities, high-yielding variety seeds, pesticides, fertilisers, tractors etc. The positive outcome of this is that farmers earn more income and have a higher purchasing power (real income). Their demand for other products in the economy will rise and this will provide industrialists an incentive to invest in that country. Thus, the size of the market expands and improves the condition of the underdeveloped country.

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

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

Export pessimism

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

However, Nurkse clarified that the finance for this development must arise to as large an extent as possible from the underdeveloped country itself i.e. domestically. He stated that financing through increased trade or foreign investments was a strategy used in the past – the 19th century – and its success was limited to the case of the United States of America. In reality, the so-called "new countries" of the United States of America (which separated from the British empire) were high income countries to begin with. They were already endowed with efficient producers, effective markets and a high purchasing power. The point Nurkse was trying to make was that USA was rich in resource endowment as well as labour force. The labour force had merely migrated from Britain to USA, and thus their level of skills were advanced to begin with. This situation of outward led growth was therefore unique and not replicable by underdeveloped countries.

In fact, if such a strategy of financing development from outside the home country is undertaken, it creates a number of problems. For example, the foreign investors may carelessly misuse the resources of the underdeveloped country. This would in turn limit that economy's ability to diversify, especially if natural resources were plundered. This may also create a distorted social structure.[8] Apart from this, there is also a risk that the foreign investments may be used to finance private luxury consumption. People would try to imitate Western consumption habits and thus a balance of payments crisis may develop, along with economic inequality within the population.

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

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

Role of state

After World War II, a debate about whether a country should introduce *financial planning* to develop itself or rely on *private entrepreneurs* emerged. Nurkse believed that the subject of who *should* promote development does not concern economists. It is an administrative problem. The crucial idea was that a large amount of well dispersed investment should be made in the economy, so that the market size expands and leads to higher productivity levels, increasing returns to scale and eventually the development of the country in question. However, most economists who favoured the balanced growth hypothesis believed that only the state has the capacity to take on the kind of heavy investments the theory propagates. Further, the gestation period of such lumpy investments is usually long and private sector entrepreneurs do not normally undertake such high risks.

Reactions

Ragnar Nurkse's balanced growth theory too has been criticised on a number of grounds. His main critic was Albert O. Hirschman, the pioneer of the strategy of unbalanced growth. Hans W. Singer also criticised certain aspects of the theory.

Hirschman stressed the fact that underdeveloped economies are called underdeveloped because they face a *lack of resources,* maybe not natural resources, but resources such as skilled labour and technology. Thus, to hypothesise that an underdeveloped nation can undertake large scale investment in many industries of its economy simultaneously is unrealistic due to the paucity of resources. To quote Hirschman,

"If a country were ready to apply the doctrine of balanced growth, then it would not be underdeveloped in the first place."

Hans Singer asserted that the balanced growth theory is more applicable to cure an economy facing a cyclical downswing. Cyclical downswing is a feature of an advanced stage of sustained growth rather than of the vicious cycle of poverty. Hirschman also stated that during conditions of slack activity in developed countries, the stock of resources, machines and entrepreneurs are merely unemployed, and are present as idle capacity. So in this situation, simultaneous investment in a large number of sectors is a well-suited policy. The various economic agents are temporarily unemployed and once the inducement to invest starts operating, the slump will be overcome. However, for an underdeveloped economy, where such resources are absent, this principle doesn't fit. Another contention was Nurkse's approval of Say's law, which theorises that there is no overproduction or glut in the economy. Supply (production of goods and services) creates a matching demand for the output and this results in the entire output being sold and consumed. However, Keynes stated that Say's law is not operational in any country because people do not spend their entire income – a fraction of it is saved for future consumption. Thus, according to Nurkse's critics, his assumption of Say's law being operational in underdeveloped countries needs greater justification. Even if the section of savers is few, the tenet of putting emphasis on supply rather than demand has been widely criticised.

Nurkse states that if demand for the output of one sector rises, due to the complementary nature of demand, the demand for the output of other industries will also experience a rise. Paul Rosenstein-Rodan spoke of a similar concept called "indivisibility of demand" which hypothesises that if large investments are made in a large number of industries simultaneously, an underdeveloped economy can become developed due to the phenomenon of complementary demand. However, both Nurkse and Rosenstein-Rodan only took into consideration the situation of industries that produce complementary goods. There are substitute goods too, which are in competition with each other. Thus if the state pumps in large investments into the car industry, for example, it will naturally lead to a rise in the demand for petrol. But if the state makes large scale investments in the coffee sector of a country, the tea sector will suffer.

Hans Singer suggested that Nurkse's theory makes dubious assumptions about the underdeveloped economy. For example, Nurkse assumes that the economy starts with nothing at hand. However, an economy usually starts at a position which reflects the previous investment decisions undertaken in the country, and at any given moment, an imbalance already exists. So the logical step would be to take on those investment programmes which complement the existing imbalance in the economy. Clearly, such an investment cannot be a balanced one. If an economy makes the mistake of setting out to make a balanced investment, a new imbalance is likely to appear which will require still another "balancing investment" to bring equilibrium, and so on and so forth.

Hirschman believed that Nurkse's balanced growth theory wasn't in fact a theory of growth. Growth implies the gradual transformation of an economy from one stage to the chronologically next stage. It entails the series of actions which leads the economy from a stage of infancy to that of maturity. However, the balanced growth theory involves the creation of a brand new, self-sufficient modern industrial economy being laid over a stagnant, self-sufficient traditional economy. Thus, there is no transformation. In reality, a dual economy will come into existence, where two separate economic sectors will begin to coexist in one country. They will differ on levels of development, technology and demand patterns. This may create inequality in the country

STRATEGY OF UNBALANCED GROWTH

Unbalanced growth is a natural path of economic development. Situations that countries are in at any one point in time reflect their previous investment decisions and development. Accordingly, at any point in time desirable investment programs that are not balanced investment packages may still advance welfare. Unbalanced investment can complement or correct existing imbalances. Once such an investment is made, a new imbalance is likely to appear, requiring further compensating investments. Therefore, growth need not take place in a balanced way. Supporters of the unbalanced growth doctrine include Albert O. Hirschman, Hans Singer, Paul Streeten, Marcus Fleming, Prof. Rostov and J. Sheehan.

Introduction

The theory is generally associated with Hirschman. He presented a complete theoretical formulation of the strategy. Underdeveloped countries display common characteristics: low levels of GNI per capita and slow GNI per capita growth, large income inequalities and widespread poverty, low levels of productivity, great dependence on agriculture, a backward industrial structure, a high proportion of consumption and low savings, high rates of population growth and dependency burdens, high unemployment and underemployment, technological backwardness. Additionally, they exhibit 'dualism', the existence of both traditional and modern sectors. In a less-developed country, these characteristics lead to scarce resources or inadequate infrastructure to exploit these resources. With a lack of investors and entrepreneurs, cash flows cannot be directed into various sectors that influence balanced economic growth.

Hirschman contends that deliberate unbalancing of the economy according to the strategy is the best method of development and if the economy is to be kept moving ahead, the task of development policy is to maintain tension, disproportions and disequilibrium. Balanced growth should not be the goal but rather the maintenance of existing imbalances, which can be seen from profit and losses. Therefore, the sequence that leads away from equilibrium is precisely an ideal pattern for development. Unequal development of various sectors often generates conditions for rapid development. More-developed industries provide undeveloped industries an incentive to grow. Hence, development of underdeveloped countries should be based on this strategy.

The path of unbalanced growth is described by three phases:

1. Complementary
2. Induced investment
3. External economies

Singer believed that desirable investment programs always exist within a country that represent unbalanced investment to complement the existing imbalance. These investments create a new imbalance, requiring another balancing investment. One sector will always grow faster than another, so the need for unbalanced growth will continue as investments must complement existing imbalance. Hirschman states “If the economy is to be kept moving ahead, the task of development policy is to maintain tensions, disproportions and disequilibrium”. This situation exists for all societies, developed or underdeveloped.

Complementarity

Complementarity is a situation where increased production of one good or service builds up demand for the second good or service. When the second product is privately produced, this demand will lead to imports or higher domestic production of the second product, as it will be in the interests of the producers to do so. Otherwise, the increased demand takes the form of political pressure. This is the case for such public services such as law and order, education, water and electricity that cannot reasonably be imported.

Induced investment

Complementarity allows investment in one industry or sector to encourage investment in others. This concept of induced investment is like a multiplier, because each investment triggers a series of subsequent events. Convergence occurs as the output of external economies diminishes at each step. Growth sequences tend to move towards convergence or divergence and the policy is usually concerned with preventing rapid convergence and promoting the possibility of divergence.

External economies

New projects often appropriate external economies[*clarification needed*] created by preceding ventures and create external economies that may be utilized by subsequent ones. Sometimes the project undertaken creates external economies, causing private profit to fall short of what is socially desirable. The reverse is also possible. Some ventures have a larger input of external economies than the output. Therefore, Hirschman says, "the projects that fall into this category must be net beneficiaries of external economies".

Social Overhead Capital

Social Overhead Capital (SOC) is defined as basic services without which primary, secondary and tertiary productive activities cannot function. In a narrow sense, Social Overhead Capital is defined to include transportation and electricity, while in a wider sense, it includes all public services, including law and order and education. Criteria for classifying an asset as Social Overhead Capital include:

- The services provided by the activity should facilitate a great variety of economic activities.
- The services provided should be subject to public control.
- The services cannot be imported.
- The investment needed to provide services should be characterized by some unevenness as well as by high capital output ratio.

Development via capital imbalances

The strategy of unbalanced growth has been discussed within the frameworks of development through shortage of SOC and development through excess of SOC.

In the first case, the country invests in direct productive activities (DPA). Direct productive activity increases demand for SOC, inducing investment. In the second case, SOC expands, which reduces the cost of services, inducing investment in DPA.

The cost of producing any unit of output of DPA is inversely proportional to SOC. The economy's major objective is to attain increasing output of DPA.

One of the paradoxes of development is that poor countries cannot afford to be economical. According to Hirschman, resources are not scarce per se, but the ability to employ those resources may be lacking. To explain unbalanced growth, Hirschman assumes that the country invests in either DPA or SOC. Both paths set up incentives and an evaluation of their respective efficiency depends on the strengths of entrepreneurial motivations and the response to public pressure of the authorities responsible for SOC.

The major characteristic of the two paths of development is that they yield excess dividends. SOC built ahead of demand creates this demand by making a country more attractive to DPA investors. DPA that outpaces SOC development, creates demand to expand SOC. Balanced growth of DPA and SOC is not achievable in underdeveloped countries, nor it is not a desirable policy, as it does not set up the incentives and the pressure that make for this dividend of induced investment decisions.

Backward and forward linkages

Hirschman introduces the concept of backward and forward linkages. A forward linkage is created when investment in a particular project encourages investment in subsequent stages of production. A backward linkage is created when a project encourages investment in facilities that enable the project to succeed. Normally, projects create both forward and backward linkages. Investment should be made in those projects that have the greatest total number of linkages. Hirschman called the industries with greatest complementarities as the 'leading sectors'. Projects with many linkages will vary from country to country; knowledge about project linkages can be obtained through input and output studies.

Most underdeveloped economies are primarily agrarian. Agriculture is typically at a primitive stage and hence possesses few linkages, as most output goes for consumption or exports. Therefore, it is said that underdeveloped countries are lacking in interdependence and linkages.

An example of an industry that has excellent forward and backward linkages is the steel industry. Backward linkages include coal and iron ore mining. Forward linkages include items such as canned goods. While this industry has strong linkages, it is not a good leading sector. Any industry that has a high capital/output ratio and causes significant costs to other businesses has the potential to hurt the developing economy more than it helps it. A better leading sector would be the beer industry.

Linkages and last industries

The development of an economy using the unbalanced method depends on the linkages between sectors. Hirschman suggests that the best strategy is induced industrialization. This type of development will create more backward and forward linkages and should be the first step taken.

Industries that transform semi-manufactured goods into goods needed by final demand are called "last industries" or "enclave import industries".

In underdeveloped countries, industrialization takes place through such industries, through plants that add final touches to unfinished imported products. Examples are metal fabricating industries, pharmaceutical laboratories and assembly and mixing plants. Such industries have many advantages, as they often require the smaller amounts of capital available in such economies and without having to rely on unreliable domestic producers. Therefore, underdeveloped countries set up such "last industries" first. These industries create long chains of backward linkages. Colombia, Brazil and Mexico are examples of countries that followed this path.

Protection and subsidy of import-replacing industries should come, but at a later stage. The Last Industry Strategy has disadvantages. It can slow the creation of domestic production. Industrialists who have begun working with imports may not accept domestic alternative products that reduce demand for their output. Creating last industries first can create loyalty toward foreign products and distrust of domestic products and their quality. Banks may get used to extending credit for shorter, smaller capital requirements.

Disadvantages

Disadvantages of the last industry strategy include inhibition of domestic production as domestic demand grows. This is because industrialists who work with imported material will often be hostile to the establishment of domestic industries, because domestic goods are of lower quality, the number of domestic suppliers is small, downstream competition may intensify once inputs are available domestically and competitors may be able to locate closer to the upstream suppliers.

Last/first may accustom domestic consumers to imported goods, making it harder for local producers to find customers. Further, financing may be easier for import-based business.

NEOCLASSICAL ECONOMICS

Neoclassical economics is an approach to economics in which the production, consumption, and valuation (pricing) of goods and services are observed as driven by the supply and demand model. According to this line of thought, the value of a good or service is determined through a hypothetical maximization of utility by income-constrained individuals and of profits by firms facing production costs and employing available information and factors of production. This approach has often been justified by appealing to rational choice theory.

Neoclassical economics is the dominant approach to microeconomics and, together with Keynesian economics, formed the neoclassical synthesis which dominated mainstream economics as "neo-Keynesian economics" from the 1950s onward.

Classification

The term was originally introduced by Thorstein Veblen in his 1900 article "Preconceptions of Economic Science", in which he related marginalists in the tradition of Alfred Marshall *et al.* to those in the Austrian School.

No attempt will here be made even to pass a verdict on the relative claims of the recognized two or three main "schools" of theory, beyond the somewhat obvious finding that, for the purpose in hand, the so-called Austrian school is scarcely distinguishable from the neo-classical, unless it be in the different distribution of emphasis. The divergence between the modernized classical views, on the one hand, and the historical and Marxist schools, on the other hand, is wider, so much so, indeed, as to bar out a consideration of the postulates of the latter under the same head of inquiry with the former.

It was later used by John Hicks, George Stigler, and others[6] to include the work of Carl Menger, William Stanley Jevons, Léon Walras, John Bates Clark, and many others. Today it is usually used to refer to mainstream economics, although it has also been used as an umbrella term encompassing a number of other schools of thought, notably excluding institutional economics, various historical schools of economics, and Marxian economics, in addition to various other heterodox approaches to economics.

Neoclassical economics is characterized by several assumptions common to many schools of economic thought. There is not a complete agreement on what is meant by neoclassical economics, and the result is a wide range of neoclassical approaches to various problem areas and domains—ranging from neoclassical theories of labor to neoclassical theories of demographic changes.

Theory

Assumptions and objectives

It was expressed by E. Roy Weintraub that neoclassical economics rests on three assumptions, although certain branches of neoclassical theory may have different approaches:

- People have rational preferences between outcomes that can be identified and associated with values.
- Individuals maximize utility and firms maximize profits.
- People act independently on the basis of full and relevant information.

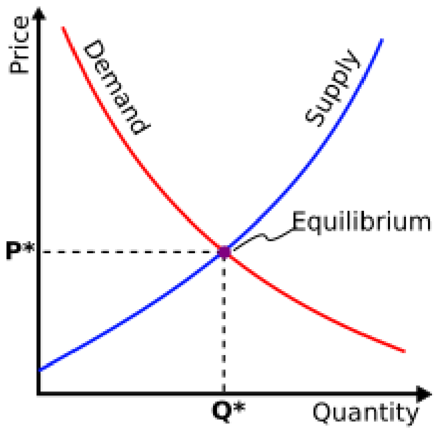
From these three assumptions, neoclassical economists have built a structure to understand the allocation of scarce resources among alternative ends—in fact, understanding such allocation is often considered the definition of economics to neoclassical theorists. Here is how William Stanley Jevons presented "the problem of Economics".

Given, a certain population, with various needs and powers of production, in possession of certain lands and other sources of material: required, the mode of employing their labor which will maximize the utility of their produce.

From the basic assumptions of neoclassical economics comes a wide range of theories about various areas of economic activity. For example, profit maximization lies behind the neoclassical theory of the firm, while the derivation of demand curves leads to an understanding of consumer goods, and the supply curve allows an analysis of the factors of production. Utility maximization is the source for the neoclassical theory of consumption, the derivation of demand curves for consumer goods, and the derivation of labor supply curves and reservation demand.

Supply and demand model

Market analysis is typically the neoclassical answer to price questions, such as why does an apple cost less than an automobile, why does the performance of work command a wage, or how to account for interest as a reward for saving. An important device of neoclassical market analysis is the graph presenting supply and demand curves. The curves reflect the behavior of individual buyers and individual sellers. Buyers and sellers interact with each other in and through these markets, and their interactions determine the market prices of anything they buy and sell. In the following graph, the specific price of the commodity being bought/sold is represented by P*.



In reaching agreed outcomes of their interactions, the market behaviors of buyers and sellers are driven by their preferences (= wants, utilities, tastes, choices) and productive abilities (= technologies, resources). This creates a complex relationship between buyers and sellers. Thus, the geometrical analytics of supply and demand is only a simplified way how to describe and explore their interaction. Market supply and demand are aggregated across firms and individuals. Their interactions determine equilibrium output and price. The market supply and demand for each factor of production is derived analogously to those for market final output[13] to determine equilibrium income and the income distribution. Factor demand incorporates the marginal productivity relationship of that factor in the output market.

Neoclassical economics emphasizes equilibria, which are the solutions of agent maximization problems. Regularities in economies are explained by methodological individualism, the position that economic phenomena can be explained by aggregating over the behavior of agents. The emphasis is on microeconomics. Institutions, which might be considered as before and conditioning individual behavior, are de-emphasized. Economic subjectivism accompanies these emphases. See also general equilibrium.

Utility theory of value

Neoclassical economics uses the utility theory of value, which states that the value of a good is determined by the marginal utility experienced by the user. This is one of the main distinguishing factors between neoclassical economics and other earlier economic theories, such as Classical and Marxian, which use the labor theory of value that value is determined by the labor required for production.

The partial definition of the neoclassical theory of value states that the value of an object of market exchange is determined by human interaction between the preferences and productive abilities of individuals. This is one of the most important neoclassical hypotheses. However, the neoclassical theory also asks what exactly is causing the supply and demand behaviors of buyers and sellers, and how exactly the preferences and productive abilities of people determine the market prices. Therefore, the neoclassical theory of value is a theory of these forces: the preferences and productive abilities of humans. They are the final causal determinants of the behavior of supply and demand and therefore of value. According to neoclassical economics, individual preferences and productive abilities are the essential forces that generate all other economic events (demands, supplies, and prices).

Market failure and externalities

Despite favoring markets to organize economic activity, neoclassical theory acknowledges that markets do not always produce the socially desirable outcome due to the presence of externalities. Externalities are considered a form of market failure. Neoclassical economists vary in terms of the significance they ascribe to externalities in market outcomes.

Pareto criterion

In a market with a very large number of participants and under appropriate conditions, for each good, there will be a unique price that allows all welfare–improving transactions to take place. This price is determined by the actions of the individuals pursuing their preferences. If these prices are flexible, meaning that all parties are able to pursue transactions at any rates they find mutually beneficial, they will, under appropriate assumptions, tend to settle at price levels that allow for all welfare–improving transactions. Under these assumptions, free-market processes yield an optimum of social welfare. This type of group welfare is called the Pareto optimum (criterion) after its discoverer Vilfredo Pareto. Wolff and Resnick (2012) describe the Pareto optimality in another way. According to them, the term "Pareto optimal point" signifies the equality of consumption and production, which indicates that the demand (as a ratio of marginal utilities) and supply (as a ratio of marginal costs) sides of an economy are in balance with each other. The Pareto optimum point also signifies that society has fully realized its potential output.

Normative judgments in neoclassical economics are shaped by the Pareto criterion. As a result, many neoclassical economists favor a relatively laissez-faire approach to government intervention in markets, since it is very difficult to make a change where no one will be worse off. However, many less conservative neoclassical economists instead use the compensation principle, which says that an intervention is good if the total gains are larger than the total losses, even if losers are not compensated in practice.

International trade

Neoclassical economics favors free trade according to David Ricardo's theory of comparative advantage.[21] This idea holds that free trade between two countries is mutually beneficial because it allows the greatest total consumption in both countries.

Origins

Classical economics, developed in the 18th and 19th centuries, included a value theory and distribution theory. The value of a product was thought to depend on the costs involved in producing that product. The explanation of costs in classical economics was simultaneously an explanation of distribution. A landlord received rent, workers received wages, and a capitalist tenant farmer received profits on their investment. This classic approach included the work of Adam Smith and David Ricardo.

However, some economists gradually began emphasizing the perceived value of a good to the consumer. They proposed a theory that the value of a product was to be explained with differences in utility (usefulness) to the consumer. (In England, economists tended to conceptualize utility in keeping with the utilitarianism of Jeremy Bentham and later of John Stuart Mill.)

The third step from political economy to economics was the introduction of marginalism and the proposition that economic actors made decisions based on margins. For example, a person decides to buy a second sandwich based on how full he or she is after the first one, a firm hires a new employee based on the expected increase in profits the employee will bring. This differs from the aggregate decision-making of classical political economy in that it explains how vital goods such as water can be cheap, while luxuries can be expensive.

Marginal revolution

The change in economic theory from classical to neoclassical economics has been called the "marginal revolution", although it has been argued that the process was slower than the term suggests. It is frequently dated from William Stanley Jevons's *Theory of Political*

Economy (1871), Carl Menger's *Principles of Economics* (1871), and Léon Walras's *Elements of Pure Economics* (1874–1877). Historians of economics and economists have debated:

- Whether utility or marginalism was more essential to this revolution (whether the noun or the adjective in the phrase "marginal utility" is more important)
- Whether there was a revolutionary change of thought or merely a gradual development and change of emphasis from their predecessors
- Whether grouping these economists together disguises differences more important than their similarities.

In particular, Jevons saw his economics as an application and development of Jeremy Bentham's utilitarianism and never had a fully developed general equilibrium theory. Menger did not embrace this hedonic conception, explained diminishing marginal utility in terms of subjective prioritization of possible uses, and emphasized disequilibrium and the discrete; further, Menger had an objection to the use of mathematics in economics, while the other two modeled their theories after 19th-century mechanics.[24] Jevons built on the hedonic conception of Bentham or of Mill, while Walras was more interested in the interaction of markets than in explaining the individual psyche.

Alfred Marshall's textbook, *Principles of Economics* (1890), was the dominant textbook in England a generation later. Marshall's influence extended elsewhere; Italians would compliment Maffeo Pantaleoni by calling him the "Marshall of Italy". Marshall thought classical economics attempted to explain prices by the cost of production. He asserted that earlier marginalists went too far in correcting this imbalance by overemphasizing utility and demand. Marshall thought that "We might as reasonably dispute whether it is the upper or the under blade of a pair of scissors that cuts a piece of paper, as to whether the value is governed by utility or cost of production".

Marshall explained price by the intersection of supply and demand curves. The introduction of different market "periods" was an important innovation of Marshall's:

- Market period. The goods produced for sale on the market are taken as given data, e.g. in a fish market. Prices quickly adjust to clear markets.
- Short period. Industrial capacity is taken as given. The level of output, the level of employment, the inputs of raw materials, and prices fluctuate to equate marginal

cost and marginal revenue, where profits are maximized. Economic rents exist in short period equilibrium for fixed factors, and the rate of profit is not equated across sectors.

- Long period. The stock of capital goods, such as factories and machines, is not taken as given. Profit-maximizing equilibria determine both industrial capacity and the level at which it is operated.
- Very long period. Technology, population trends, habits, and customs are not taken as given but allowed to vary in very long period models.

Marshall took supply and demand as stable functions and extended supply and demand explanations of prices to all runs. He argued supply was easier to vary in longer runs, and thus became a more important determinant of price in the very long run.

Cambridge and Lausanne school

Cambridge and Lausanne School of economics form the basis of neoclassical economics. Until the 1930s, the evolution of neoclassical economics was determined by the Cambridge school and was based on the marginal equilibrium theory. At the beginning of the 1930s, the Lausanne general equilibrium theory became the general basis of neoclassical economics and the marginal equilibrium theory was understood as its simplification.

The thinking of the Cambridge school continued in the steps of classical political economics and its traditions but was based on the new approach that originated from the marginalist revolution. Its founder was Alfred Marshall, and among the main representatives were Arthur Cecil Pigou, Ralph George Hawtrey and Dennis Holme Robertson. Pigou worked on the theory of welfare economics and the quantity theory of money. Hawtrey and Robertson developed the Cambridge cash balance approach to theory of money and influenced the trade cycle theory. Until the 1930s, John Maynard Keynes was also influencing the theoretical concepts of the Cambridge school. The key characteristic of the Cambridge school was its instrumental approach to the economy – the role of the theoretical economist is first to define theoretical instruments of economic analysis and only just then apply them to real economic problems.

The main representatives of the Lausanne school of economic thought were Léon Walras, Vilfredo Pareto and Enrico Barone. The school became famous for developing the general equilibrium theory. In the contemporary economy, the general equilibrium theory is the methodologic basis of mainstream economics in the form of New classical macroeconomics and New Keynesian macroeconomics.

Evolution

The evolution of neoclassical economics can be divided into three phases. The first phase (= a pre-Keynesian phase) is dated between the initial forming of neoclassical economics (the second half of the nineteenth century) and the arrival of Keynesian economics in the 1930s. The second phase is dated between the year 1940 and the half of the 1970s. During this era, Keynesian economics was dominating the world's economy but neoclassical economics did not cease to exist. It continued in the development of its microeconomics theory and began creating its own macroeconomics theory. The development of the neoclassical macroeconomic theory was based on the development of the quantity theory of money and the theory of distribution. One of the products of the second phase was the Neoclassical synthesis, representing a special combination of neoclassical microeconomics and Keynesian macroeconomics. The third phase began in the 1970s. During this era, Keynesian economics was in crisis, which encouraged the creation of new neoclassical lines of thoughts such as Monetarism and New classical macroeconomics. Despite the diverse focus and approach of these theories, they are all based on the theoretic and methodologic principles of traditional neoclassical economics.

An important change in neoclassical economics occurred around 1933. Joan Robinson and Edward H. Chamberlin, with the nearly simultaneous publication of their respective books, *The Economics of Imperfect Competition* (1933) and *The Theory of Monopolistic Competition* (1933), introduced models of imperfect competition. Theories of market forms and industrial organization grew out of this work. They also emphasized certain tools, such as the marginal revenue curve. In her book, Robinson formalized a type of limited competition. The conclusions of her work for welfare economics were worrying: they were implying that the market mechanism operates in a way that the workers are not paid according to the full value of their marginal productivity of labor and that also the principle of consumer sovereignty is impaired. This theory heavily influenced the anti–trust policies of many Western countries in the 1940s and 1950s.

Joan Robinson's work on imperfect competition, at least, was a response to certain problems of Marshallian partial equilibrium theory highlighted by Piero Sraffa. Anglo-American economists also responded to these problems by turning towards general equilibrium theory, developed on the European continent by Walras and Vilfredo Pareto. J. R. Hicks's *Value and Capital* (1939) was influential in introducing his English-speaking colleagues to these traditions. He, in turn, was influenced by the Austrian School economist Friedrich Hayek's move to the London School of Economics, where Hicks then studied.

These developments were accompanied by the introduction of new tools, such as indifference curves and the theory of ordinal utility. The level of mathematical sophistication of neoclassical economics increased. Paul Samuelson's *Foundations of Economic Analysis* (1947) contributed to this increase in mathematical modeling.

The interwar period in American economics has been argued to have been pluralistic, with neoclassical economics and institutionalism competing for allegiance. Frank Knight, an early Chicago school economist attempted to combine both schools. But this increase in mathematics was accompanied by greater dominance of neoclassical economics in Anglo-American universities after World War II. Some argue that outside political interventions, such as McCarthyism, and internal ideological bullying played an important role in this rise to dominance.

Hicks' book, *Value and Capital* had two main parts. The second, which was arguably not immediately influential, presented a model of temporary equilibrium. Hicks was influenced directly by Hayek's notion of intertemporal coordination and paralleled by earlier work by Lindhal. This was part of an abandonment of disaggregated long-run models. This trend probably reached its culmination with the Arrow–Debreu model of intertemporal equilibrium. The Arrow–Debreu model has canonical presentations in Gérard Debreu's *Theory of Value* (1959) and in Arrow and Hahn's "General Competitive Analysis" (1971).

Neoclassical synthesis

Many of these developments were against the backdrop of improvements in both econometrics, that is the ability to measure prices and changes in goods and services, as well as their aggregate quantities, and in the creation of macroeconomics, or the study of whole economies. The attempt to combine neo-classical microeconomics and Keynesian macroeconomics would lead to the neoclassical synthesis which was the dominant paradigm of economic reasoning in English-speaking countries from the 1950s till the 1970s. Hicks and Samuelson were for example instrumental in mainstreaming Keynesian economics.

The dominance of Keynesian economics was upset by its inability to explain the economic crises of the 1970s- neoclassical economics emerged distinctly in macroeconomics as the new classical school, which sought to explain macroeconomic phenomenon using neoclassical microeconomics. It and its contemporary New Keynesian economics contributed to the new neoclassical synthesis of the 1990s, which informs much of mainstream macroeconomics today.

Cambridge capital controversy

Problems exist with making the neoclassical general equilibrium theory compatible with an economy that develops over time and includes capital goods. This was explored in a major debate in the 1960s—the "Cambridge capital controversy"—about the validity of neoclassical economics, with an emphasis on economic growth, capital, aggregate theory, and the marginal productivity theory of distribution. There were also internal attempts by neoclassical economists to extend the Arrow–Debreu model to disequilibrium investigations of stability and uniqueness. However, a result known as the Sonnenschein–Mantel–Debreu theorem suggests that the assumptions that must be made to ensure that equilibrium is stable and unique are quite restrictive.

Criticisms

Although the neoclassical approach is dominant in economics, the field of economics includesothers, such as Marxist, behavioral, Schumpeterian, developmentalist, Austrian, post-Keynesian, Humanistic economics, real-world economics and institutionalist schools. All of these schools differ with the neoclassical school and each other, and incorporate various criticisms of the neoclassical economics.[36] Not all criticism comes from other schools: some prominent economists such as Nobel Prize recipient and former chief economist of the World Bank Joseph Stiglitz are vocally critical of mainstream neoclassical economics.

Methodology and mathematical models

Further information: Unreasonable ineffectiveness of mathematics § Economics and finance, and Financial economics § Challenges and criticism

Some see mathematical models used in contemporary research in mainstream economics as having transcended neoclassical economics, while others disagree. Mathematical models also include those in game theory, linear programming, and econometrics. Critics of neoclassical economics are divided into those who think that highly mathematical method is inherently wrong and those who think that mathematical method is useful even if neoclassical economics has other problems.

Critics such as Tony Lawson contend that neoclassical economics' reliance on functional relations is inadequate for social phenomena in which knowledge of one variable does not reliably predict another.[41] The different factors affecting economic outcomes cannot be experimentally isolated from one another in a laboratory; therefore the explanatory and predictive power of mathematical economic analysis is limited. Lawson proposes an alternative approach called the contrast explanation which he says is better suited for determining causes of events in social sciences. More broadly, critics of economics as a science vary, with some believing that all mathematical economics is problematic or even pseudoscience and others believing it is still useful but has less certainty and higher risk of methodology problems than in other fields.

Milton Friedman, one of the most prominent and influential neoclassical economists of the 20th century, responded to criticisms that assumptions in economic models were often unrealistic by saying that theories should be judged by their ability to predict events rather than by the supposed realism of their assumptions.[44] He claimed that, on the contrary, a theory with more absurd assumptions has stronger predictive power. He argued that a theory's ability to theoretically explain reality is irrelevant compared to its ability to empirically predict reality, no matter the method of getting to that prediction.

Objectivity and pluralism

Neoclassical economics is often criticized for having a normative bias despite sometimes claiming to be "value-free". Such critics argue an ideological side of neoclassical economics, generally to argue that students should be taught more than one economic theory and that economics departments should be more pluralistic.

Rational behavior assumptions

One of the most widely criticized aspects of neoclassical economics is its set of assumptions about human behavior and rationality. The "economic man", or a hypothetical human who acts according to neoclassical assumptions, does not necessarily behave the same way as humans do in reality. The economist and critic of capitalism Thorstein Veblen claimed that neoclassical economics assumes a person to be "a lightning calculator of pleasures and pains, who oscillates like a homogeneous globule of desire of happiness under the impulse of stimuli that shift about the area, but leave him intact."

Veblen's characterization references a number of commonly criticized rationality assumptions: that people make decisions using a rigid utilitarian framework, have perfect information available about their options, have perfect information processing ability allowing them to immediately calculate utility for all possible options, and are independent decision-makers whose choices are unaffected by their surroundings or by other people. While Veblen is from the Institutional school, the Behavioral school of economics is focused on studying the mechanisms of human decision-making and how they differ from neoclassical assumptions of rationality. Altruistic or empathy-based behavior is another form of "non-rational" decision making studied by behavioral economists, which differs from the neoclassical assumption that people only act in self-interest. Behavioral economists account for how psychological, neurological, and even emotional factors significantly affect economic perceptions and behaviors.

Rational choice theory need not be problematic according to a paper written by the economist Gary Becker which was published in 1962 in the *Journal of Political Economy* called "Irrational Behavior and Economic Theory". According to Becker, this paper demonstrates "how the important theorems of modern economics result from a general principle which not only includes rational behavior and survivor arguments as special cases, but also much irrational behavior." The specific important theorems and results which are shown to result from a broad range of different type of irrational behavior, as well as rational behavior by market participants in the paper, are that market demand curves are downward sloping or "negatively inclined", and that if an industry transformed from a competitive industry to a completely monopolistic cartel and profits are always maximized, then output per firm under the cartel would decrease compared to its equilibrium level when the industry was competitive.

This paper was largely based on the 1950 paper "Uncertainty, Evolution, and Economic Theory" by Armen Alchian. The paper sets out a justification for supply analysis separate from relying on the assumption of rational consumption, the representative firm and the way neoclassical economists analyze firm behavior in markets which does not rely on rational behavior by the decision makers in those firms, nor any other type of foresighted or goal directed behavior by them. Becker's subsequent 1962 paper provides an independent justification for neoclassical market demand analysis. The two papers offer separate justifications for the use of neoclassical methodology for supply and demand analysis without relying on assumptions otherwise criticised as implausible.

Methodological individualism

Neoclassical economics offers an approach to studying the economic behavior of *homo-economicus*. This theory is based on methodological individualism and adopts an atomistic approach to social phenomena, according to which social atoms are the individuals and their actions. According to this doctrine, individuals are independent of social phenomena, but the opposite is not true. Individuals' actions can explain macro-scale behavior, and social collections are nothing more than aggregates, and they do not add anything to its components (Ibid). Although methodological individualism does not negate complex social phenomena such as institutions or behavioral rules, it argues any explanation should be based on constituent components' characteristics of those institutions. This is a reductionist approach based on which it is believed that the characteristics of the social system are derived from the individuals' preferences and their actions.

A critique of this approach is that the individuals' preferences and interests are not fixed. The structures contextualize individual's. According to social constructivists, systems are co-constituted alongside the actors, and ideas within the system define actors' identities, their interests, and thus their behavior.[In this regard, actors in various circumstances (exposed to different impressions and experiences) will construct their interests and preferences differently, both within each other and over time. Given the individualistic foundation of the economic theory, critics argue that this theory should consider individual action's structural contexts.

Inequality

Neoclassical economics is often criticized as promoting policies that increase inequality and as failing to recognise the impact of inequality on economic outcomes. In the case of the former claim, neoclassical economics is often used for analysis in support of policies reducing economic inequality—in particular through determining the diminishing marginal utility of income, whereby poorer individuals gain greater net benefits from a given increase in income than comparable richer individuals, but more generally by being the primary means by which the impact on inequality of any given policy is assessed.

In the case of the latter claim, neoclassical economics is the prevailing lens through which the relationship between inequality and economic outcomes is studied.

Ethics of markets

Neoclassical economics tends to promote commodification and privatization of goods due to its principle that market exchange generally results in the most effective allocation of goods. For example, some economists support markets for human organs, on the basis that it increases supply of life-saving organs and benefits willing donors financially. However, there are arguments in moral philosophy that use of markets for certain goods is inherently unethical. Political philosopher Michael Sandel summarizes that market exchanges have two ethical problems: coercion and corruption. Coercion happens because market participation may not be as free as proponents often claim: people often participate in markets because it is the only way to survive, which is not truly voluntary. Corruption describes how commodification of a good can inherently degrade its value.

SOLOW–SWAN MODEL

The Solow–Swan model or exogenous growth model is an economic model of long-run economic growth. It attempts to explain long-run economic growth by looking at capital accumulation, labor or population growth, and increases in productivity largely driven by technological progress. At its core, it is an aggregate production function, often specified to be of Cobb–Douglas type, which enables the model "to make contact with microeconomics". The model was developed independently by Robert Solow and Trevor Swan in 1956, and superseded the Keynesian Harrod–Domar model.

Mathematically, the Solow–Swan model is a nonlinear system consisting of a single ordinary differential equation that models the evolution of the *per capita* stock of capital. Due to its particularly attractive mathematical characteristics, Solow–Swan proved to be a convenient starting point for various extensions. For instance, in 1965, David Cass and Tjalling Koopmans integrated Frank Ramsey's analysis of consumer optimization,[4] thereby endogenizing[5] the saving rate, to create what is now known as the Ramsey–Cass–Koopmans model.

Background

The Solow–Swan model was an extension to the 1946 Harrod–Domar model that dropped the restrictive assumption that only capital contributes to growth (so long as there is sufficient labor to use all capital). Important contributions to the model came from the work done by Solow and by Swan in 1956, who independently developed relatively simple growth models. Solow's model fitted available data on US economic growth with some success. In 1987 Solow was awarded the Nobel Prize in Economics for his work. Today, economists use Solow's sources-of-growth accounting to estimate the separate effects on economic growth of technological change, capital, and labor.

The Solow model is also one of the most widely used models in economics to explain economic growth. Basically, it asserts that outcomes on the "total factor productivity (TFP) can lead to limitless increases in the standard of living in a country."

Extension to the Harrod–Domar model

Solow extended the Harrod–Domar model by adding labor as a factor of production and capital-output ratios that are not fixed as they are in the Harrod–Domar model. These refinements allow increasing capital intensity to be distinguished from technological progress. Solow sees the fixed proportions production function as a "crucial assumption" to the instability results in the Harrod-Domar model. His own work expands upon this by exploring the implications of alternative specifications, namely the Cobb–Douglas and the more general constant elasticity of substitution (CES). Although this has become the canonical and celebrated story[9] in the history of economics, featured in many economic textbooks, recent reappraisal of Harrod's work has contested it. One central criticism is that Harrod's original piece was neither mainly concerned with economic growth nor did he explicitly use a fixed proportions production function.

Long-run implications

A standard Solow model predicts that in the long run, economies converge to their balanced growth equilibrium and that permanent growth of per capita income is achievable only through technological progress. Both shifts in saving and in population growth cause only level effects in the long-run (i.e. in the absolute value of real income per capita). An interesting implication of Solow's model is that poor countries should grow faster and eventually catch-up to richer countries. This convergence could be explained by

- Lags in the diffusion on knowledge. Differences in real income might shrink as poor countries receive better technology and information;
- Efficient allocation of international capital flows, since the rate of return on capital should be higher in poorer countries. In practice, this is seldom observed and is known as Lucas' paradox;
- A mathematical implication of the model (assuming poor countries have not yet reached their steady state).

Baumol attempted to verify this empirically and found a very strong correlation between a countries' output growth over a long period of time (1870 to 1979) and its initial wealth. His findings were later contested by DeLong who claimed that both the non-randomness of the sampled countries, and potential for significant measurement errors for estimates of real income per capita in 1870, biased Baumol's findings. DeLong concludes that there is little evidence to support the convergence theory.

Assumptions

The key assumption of the Solow–Swan growth model is that capital is subject to diminishing returns in a closed economy.

- Given a fixed stock of labor, the impact on output of the last unit of capital accumulated will always be less than the one before.
- Assuming for simplicity no technological progress or labor force growth, diminishing returns implies that at some point the amount of new capital produced is only just enough to make up for the amount of existing capital lost due to depreciation. At this point, because of the assumptions of no technological progress or labor force growth, we can see the economy ceases to grow.
- Assuming non-zero rates of labor growth complicate matters somewhat, but the basic logic still applies – in the short-run, the rate of growth slows as diminishing returns take effect and the economy converges to a constant "steady-state" rate of growth (that is, *no* economic growth per-capita).
- Including non-zero technological progress is very similar to the assumption of non-zero workforce growth, in terms of "effective labor": a new steady state is reached with constant output per *worker-hour required for a unit of output*. However, in this case, per-

capita output grows at the rate of technological progress in the "steady-state" (that is, the rate of productivity growth).

Variations in the effects of productivity

In the Solow–Swan model the unexplained change in the growth of output after accounting for the effect of capital accumulation is called the Solow residual. This residual measures the exogenous increase in total factor productivity (TFP) during a particular time period. The increase in TFP is often attributed entirely to technological progress, but it also includes any permanent improvement in the efficiency with which factors of production are combined over time. Implicitly TFP growth includes any permanent productivity improvements that result from improved management practices in the private or public sectors of the economy. Paradoxically, even though TFP growth is exogenous in the model, it cannot be observed, so it can only be estimated in conjunction with the simultaneous estimate of the effect of capital accumulation on growth during a particular time period.

The model can be reformulated in slightly different ways using different productivity assumptions, or different measurement metrics:

- Average Labor Productivity (ALP) is economic output per labor hour.
- Multifactor productivity (MFP) is output divided by a weighted average of capital and labor inputs. The weights used are usually based on the aggregate input shares either factor earns. This ratio is often quoted as: 33% return to capital and 67% return to labor (in Western nations).

In a growing economy, capital is accumulated faster than people are born, so the denominator in the growth function under the MFP calculation is growing faster than in the ALP calculation. Hence, MFP growth is almost always lower than ALP growth. (Therefore, measuring in ALP terms increases the apparent capital deepening effect.) MFP is measured by the "Solow residual", not ALP.

KALDOR'S GROWTH MODEL

Nicholas Kaldor in his essay titled A Model of Economic Growth, originally published in Economic Journal in 1957, postulates a growth model, which follows the Harrodian dynamic approach and the Keynesian techniques of analysis. In his growth model, Kaldor attempts “to provide a framework for relating the genesis of technical progress to capital accumulation", whereas the other neoclassical models treat the causation of technical progress as completely exogenous.

According to Kaldor, "*The purpose of a theory of economic growth is to show the nature of non-economic variables which ultimately determine the rate at which the general level of production of the economy is growing, and thereby contribute to an understanding of the question of why some societies grow so much faster than others.*"

Assumptions

The basic properties of Kaldor's growth model are as follows:

1. *Short period supply of aggregate goods and services in a growing economy is inelastic and not affected by any increase in effective monetary demand. As it is based on the Keynesian assumption of "full employment".*
2. *The technical progress depends on the rate of capital accumulation.* Kaldor postulates the "technical progress function", which shows a relationship between the growth of capital and productivity, incorporating the influence of both the factors. Where the capital-output ratio will depend upon the relationship of the growth of capital and the growth of productivity.
3. *Wages and profits constitute the income*, where wages comprise salaries and earnings of manual labor, and profits comprise incomes of entrepreneurs as well as property owners. And total savings consist of savings out of wages and savings out of profit.
4. *General price level is constant.*

DEPENDENCY THEORY

Dependency theory is the idea that resources flow from a "periphery" of poor and exploited states to a "core" of wealthy states, enriching the latter at the expense of the former. A central contention of dependency theory is that poor states are impoverished and rich ones enriched by the way poor states are integrated into the "world system". This theory was officially developed in the late 1960s following World War II, as scholars searched for the root issue in the lack of development in Latin America.

The theory arose as a reaction to modernization theory, an earlier theory of development which held that all societies progress through similar stages of development, that today's underdeveloped areas are thus in a similar situation to that of today's developed areas at some time in the past, and that, therefore, the task of helping the underdeveloped areas out of poverty is to accelerate them along this supposed common path of development, by various means such as investment, technology transfers, and closer integration into the world market. Dependency theory rejected this view, arguing that underdeveloped countries are not merely primitive versions of developed countries, but have unique features and structures of their own; and, importantly, are in the situation of being the weaker members in a world market economy.

Some writers have argued for its continuing relevance as a conceptual orientation to the global division of wealth. Dependency theorists can typically be divided into two categories: liberal reformists and neo-Marxists. Liberal reformists typically advocate for targeted policy interventions, while the neo-Marxists propose a planned economy.

Basics

The premises of dependency theory are that:

1. Poor nations provide natural resources, cheap labour, a destination for obsolete technology, and markets for developed nations, without which the latter could not have the standard of living they enjoy.
2. Wealthy nations actively perpetuate a state of dependence by various means. This influence may be multifaceted, involving economics, media control, politics, banking and finance, education, culture, and sport.

History

Dependency theory originates with two papers published in 1949, one by Hans Singer and one by Raúl Prebisch, in which the authors observe that the terms of trade for underdeveloped countries relative to the developed countries had deteriorated over time: the underdeveloped countries were able to purchase fewer and fewer manufactured goods from the developed countries in exchange for a given quantity of their raw materials exports. This idea is known as the Prebisch–Singer thesis. Prebisch, an Argentine economist at the United Nations Commission for Latin America (UNCLA), went on to conclude that the underdeveloped nations must employ some degree of protectionism in trade if they were to enter a self-sustaining development path. He argued that import-substitution industrialisation (ISI), not a trade-and-export orientation, was the best strategy for underdeveloped countries. The theory was developed from a Marxian perspective by Paul A.

Baran in 1957 with the publication of his *The Political Economy of Growth*.[7] Dependency theory shares many points with earlier, Marxist, theories of imperialism by Rosa Luxemburg and Vladimir Lenin, and has attracted continued interest from Marxists. Some authors identify two main streams in dependency theory: the Latin American Structuralist, typified by the work of Prebisch, Celso Furtado, and Aníbal Pinto at the United Nations Economic Commission for Latin America (ECLAC, or, in Spanish, CEPAL); and the American Marxist, developed by Paul A. Baran, Paul Sweezy, and Andre Gunder Frank.

Using the Latin American dependency model, the Guyanese Marxist historian Walter Rodney, in his book *How Europe Underdeveloped Africa*, described in 1972 an Africa that had been consciously exploited by European imperialists, leading directly to the modern underdevelopment of most of the continent.

The theory was popular in the 1960s and 1970s as a criticism of modernization theory, which was falling increasingly out of favor because of continued widespread poverty in much of the world. At that time the assumptions of liberal theories of development were under attack.[9] It was used to explain the causes of overurbanization, a theory that urbanization rates outpaced industrial growth in several developing countries.

The Latin American Structuralist and the American Marxist schools had significant differences but, according to economist Matias Vernengo, they agreed on some basic points:

[B]oth groups would agree that at the core of the dependency relation between center and periphery lays [lies] the inability of the periphery to develop an autonomous and dynamic process of technological innovation. Technology – the Promethean force unleashed by the Industrial Revolution – is at the center of stage. The Center countries controlled the technology and the systems for generating technology. Foreign capital could not solve the problem, since it only led to limited transmission of technology, but not the process of innovation itself. Baran and others frequently spoke of the international division of labour – skilled workers in the center; unskilled in the periphery – when discussing key features of dependency.

Baran placed surplus extraction and capital accumulation at the center of his analysis. Development depends on a population's producing more than it needs for bare subsistence (a surplus). Further, some of that surplus must be used for capital accumulation – the purchase of new means of production – if development is to occur; spending the surplus on things like luxury consumption does not produce development. Baran noted two predominant kinds of economic activity in poor countries. In the older of the two, plantation agriculture, which originated in colonial times, most of the surplus goes to the landowners, who use it to emulate the consumption patterns of wealthy people in the developed world; much of it thus goes to purchase foreign-produced luxury items –automobiles, clothes, etc. – and little is accumulated for investing in development. The more recent kind of economic activity in the periphery is industry—but of a particular kind. It is usually carried out by foreigners, although often in conjunction with local interests. It is often under special tariff protection or other government concessions. The surplus from this production mostly goes to two places: part of it is sent back to the foreign shareholders as profit; the other part is spent on conspicuous consumption in a similar fashion to that of the plantation aristocracy. Again, little is used for development. Baran thought that political revolution was necessary to break this pattern.

In the 1960s, members of the Latin American Structuralist school argued that there is more latitude in the system than the Marxists believed. They argued that it allows for partial development or "dependent development"–development, but still under the control of outside decision makers. They cited the partly successful attempts at industrialisation in Latin America around that time (Argentina, Brazil, Mexico) as evidence for this hypothesis. They were led to the position that dependency is not a relation between commodity exporters and industrialised countries, but between countries with different degrees of industrialisation. In their approach, there is a distinction made between the economic and political spheres: economically, one may be developed or underdeveloped; but even if (somewhat) economically developed, one may be politically autonomous or dependent. More recently, Guillermo O'Donnell has argued that constraints placed on development by neoliberalism were lifted by the military coups in Latin America that came to promote development in authoritarian guise (O'Donnell, 1982).

These positions particularly in regard of Latin America were notably challenged theoretically in the work and teaching of Ruy Mauro Marini who developed wider recognition for a specifically Marxist Dependency Theory, after close reading of Marx, that super-exploitation and unequal exchange characteristically arose out of the specific forms in the capital reproduction of dependency, and the specific class relations particular to that dependency in the periphery .[13]

The importance of multinational corporations and state promotion of technology were emphasised by the Latin American Structuralists.

Fajnzylber has made a distinction between systemic or authentic competitiveness, which is the ability to compete based on higher productivity, and spurious competitiveness, which is based on low wages.

The third-world debt crisis of the 1980s and continued stagnation in Africa and Latin America in the 1990s caused some doubt as to the feasibility or desirability of "dependent development".

The *sine qua non* of the dependency relationship is not the difference in technological sophistication, as traditional dependency theorists believe, but rather the difference in financial strength between core and peripheral countries–particularly the inability of peripheral countries to borrow in their own currency. He believes that the hegemonic position of the United States is very strong because of the importance of its financial markets and because it controls the international reserve currency – the US dollar. He believes that the end of the Bretton Woods international financial agreements in the early 1970s considerably strengthened the United States' position because it removed some constraints on their financial actions.

"Standard" dependency theory differs from Marxism, in arguing against internationalism and any hope of progress in less developed nations towards industrialization and a liberating revolution. Theotonio dos Santos described a "new dependency", which focused on both the internal and external relations of less-developed countries of the periphery, derived from a Marxian analysis. Former Brazilian President Fernando Henrique Cardoso (in office 1995–2002) wrote extensively on dependency theory while in political exile during the 1960s, arguing that it was an approach to studying the economic disparities between the centre and periphery. Cardoso summarized his version of dependency theory as follows:

- there is a financial and technological penetration by the developed capitalist centers of the countries of the periphery and semi-periphery;
- this produces an unbalanced economic structure both within the peripheral societies and between them and the centers;
- this leads to limitations on self-sustained growth in the periphery;

- this favors the appearance of specific patterns of class relations;
- these require modifications in the role of the state to guarantee both the functioning of the economy and the political articulation of a society, which contains, within itself, foci of inarticulateness and structural imbalance.

The analysis of development patterns in the 1990s and beyond is complicated by the fact that capitalism develops not smoothly, but with very strong and self-repeating ups and downs, called cycles. Relevant results are given in studies by Joshua Goldstein, Volker Bornschier, and Luigi Scandella.

With the economic growth of India and some East Asian economies, dependency theory has lost some of its former influence. It still influences some NGO campaigns, such as Make Poverty History and the fair trade movement.

Criticism

Economic policies based on dependency theory have been criticized by free-market economists such as Peter Bauer and Martin Wolf and others:

- Lack of competition: by subsidizing in-country industries and preventing outside imports, these companies may have less incentive to improve their products, to try to become more efficient in their processes, to please customers, or to research new innovations.
- Sustainability: industries reliant on government support may not be sustainable for very long, particularly in poorer countries and countries which largely depend on foreign aid from more developed countries.
- Domestic opportunity costs: subsidies on domestic industries come out of state coffers and therefore represent money not spent in other ways, like development of domestic infrastructure, seed capital or need-based social welfare programs. At the same time, the higher prices caused by tariffs and restrictions on imports require the people either to forgo these goods altogether or buy them at higher prices, forgoing other goods.

Market economists cite a number of examples in their arguments against dependency theory. The improvement of India's economy after it moved from state-controlled business to open trade is one of the most often cited. India's example seems to contradict dependency theorists' claims concerning comparative advantage and mobility, as much as its economic growth originated from movements such as outsourcing – one of the most mobile forms of capital transfer. In Africa, states that have emphasized import-substitution development, such as Zimbabwe, have typically been among the worst performers, while the continent's most successful non-oil based economies, such as Egypt, South Africa, and Tunisia, have pursued trade-based development.

According to economic historian Robert C. Allen, dependency theory's claims are "debatable" due to fact that the protectionism that was implemented in Latin America as a solution ended up failing. The countries incurred too much debt and Latin America went into a recession. One of the problems was that the Latin American countries simply had too small national markets to be able to efficiently produce complex industrialized goods, such as automobiles.

POLICY IMPLICATIONS OF DEPENDENCY THEORY

Dependency theory, which posits that developed nations exploit developing nations for resources and labor, suggests policies should focus on breaking free from these exploitative relationships and promoting self-reliance, such as through import substitution and nationalization.

Key Policy Implications of Dependency Theory:

- Breaking Dependency:

Dependency theory suggests that developing nations should strive to reduce their dependence on developed countries, which can be achieved through policies like import substitution, nationalization of key industries, and diversification of the economy.

- Promoting Self-Reliance:

Policies should focus on building domestic industries and infrastructure, rather than relying on foreign investment and trade, to foster self-sufficiency and reduce vulnerability to external shocks.

- Redistributing Wealth:

Dependency theory emphasizes the need for policies that address the unequal distribution of wealth and power within and between nations, such as land reform, progressive taxation, and social welfare programs.

- Challenging Neo-colonialism:

Policies should challenge the dominance of transnational corporations and promote fair trade practices, as well as resist foreign interference in domestic affairs.

- Focus on Education and Technology:

Investing in education, research, and technology development is crucial for developing nations to become more competitive and self-reliant in the global economy.

- Critique of Free Market Policies:

Dependency theory often critiques free market policies, such as privatization and deregulation, arguing that they can exacerbate inequality and dependence on foreign powers.

- Emphasis on State Intervention:

Dependency theory often advocates for a greater role for the state in economic development, including planning, regulation, and social programs.

THE BIG PUSH THEORY

The Big Push Model is a concept in development economics or welfare economics that emphasizes the fact that a firm's decision whether to industrialize or not depends on the expectation of what other firms will do. It assumes economies of scale and oligopolistic market structure. It also explains when the industrialization would happen.

The major contributions to the concept of the Big Push were made by Paul Rosenstein-Rodan in 1943 and later on by Murphy, Shleifer and Vishny in 1989. Also, some contributions of Matsuyama (1992), Krugman (1991) and Romer (1986) proved to be seminal for later literature on the Big Push.

Analysis of this economic model usually involves using game theory.

The hallmark of the 'big-push' approach lies in the reaping of external economies through the simultaneous installation of a host of technically interdependent industries. But before that could become possible, we have to overcome the economic indivisibilities by moving forward by a certain “minimum indivisible step”. This can be realised through the injection of an initial big dose of a certain size of investment.

The "Big Push" theory, a concept in development economics, posits that developing countries need a large, coordinated investment across multiple sectors to overcome "indivisibilities" and jumpstart economic growth, rather than relying on gradual, piecemeal development.

JOAN ROBINSON'S GROWTH MODEL

Joan Robinson's Growth Model is a simple model of economic growth, reflecting the working of a pure capitalist economy, expounded by Joan Robinson in her 1956 book *The Accumulation of Capital*. However, *The Accumulation of Capital* was a terse book. In a later book, *Essays in the theory of Economic Growth*, she tried to lower the degree of abstraction. Robinson presented her growth model in verbal terms. A mathematical formalization was later provided by Kenneth K. Kurihara.

Assumptions:

1. There is a laissez-faire closed economy.
2. The factors of production are capital and labour only.
3. There is neutral technical progress.
4. There are only two classes: workers and capitalists, among whom the national income is distributed.
5. Workers save nothing and spend their wage income on consumption.
6. Capitalists consume nothing, but save and invest their entire income for capital formation.
7. There is no change in the price level.
8. Saving is a function of profit.

Joan Robinson's model of capital accumulation, detailed in her 1956 book "The Accumulation of Capital," is a post-Keynesian model that focuses on the dynamics of capital accumulation, income distribution, and economic growth, emphasizing the interplay between profits, wages, and the growth of an economy.

Key Features of the Model:

1. **Focus on Capital Accumulation:** Robinson's model centers on how capital accumulation, driven by profits and investment, influences economic growth and income distribution.
2. **Interplay of Profits and Wages:** The model examines the relationship between profits, wages, and the overall growth of the economy, challenging classical models that often assume full employment and equilibrium.
3. **Capitalist Rules of the Game:** Robinson's model is based on the capitalist rules of the game, where entrepreneurs accumulate capital based on the expected rate of profit.
4. **Population Growth:** The model incorporates the effects of population growth on capital accumulation and output, crucial for understanding growth in developing economies.
5. **Golden Age Equilibrium:** The model introduces the concept of a "golden age equilibrium" where the growth rate of capital and population are equal, leading to a steady state of economic growth.
6. **Income Distribution:** The model highlights how the manner in which income is distributed between wages and profits affects capital formation and economic growth.
7. **Saving and Investment:** The model emphasizes the role of saving and investment in driving capital accumulation and economic growth.

Critique of Neoclassical Theory:

Robinson's work is also a critique of the neoclassical theory of the rate of profits, proposing an alternative theory of production inspired by Ricardo, Kalecki, and Sraffa.

In essence, Robinson's model argues that:

1. Capital accumulation is driven by the desire of firms to accumulate profits.
2. The rate of capital accumulation is influenced by the distribution of income between wages and profits.
3. Population growth affects the rate of capital accumulation and output growth.
4. The economy can achieve a "golden age" equilibrium where the growth rate of capital and population are equal.

UNIT – III

POVERTY, INEQUALITY AND HUMAN CAPITAL MEASUREMENT

Poverty and inequality are complex issues, and human capital plays a crucial role in both. Inequality measures like the Gini coefficient can assess income disparities, while poverty measures like the headcount ratio assess the proportion of the population living below a certain income threshold.

1. Poverty:

Definition:

Poverty is a state where an individual or group lacks the resources to meet their basic needs, such as food, shelter, and healthcare.

Measurement:

A. Headcount Ratio: The percentage of the population living below a defined poverty line (e.g., a certain income or consumption level).

B. Poverty Gap: The average shortfall of the poor's income below the poverty line.

C. Poverty Severity: A measure that considers both the depth and intensity of poverty.

D. Multidimensional Poverty Index (MPI): Evaluates health, education, and standard of living across multiple indicators.

2. Inequality:

Definition:

Inequality refers to the unequal distribution of resources, opportunities, and outcomes within a society.

A. Measurement:

a. Gini Coefficient: A widely used measure of income inequality, ranging from 0 (perfect equality) to 1 (perfect inequality).

b. Lorenz Curve: A graphical representation of income distribution, showing the proportion of income held by different segments of the population.

c. Decile Ratio: Compares the income of the richest 10% to the poorest 10%.

d. Palma Ratio: Compares the income share of the richest 10% to the poorest 40%.

e. Theil Index: A measure of inequality that considers the distribution of income across different groups.

3. Human Capital:

Definition:

Human capital refers to the knowledge, skills, and abilities that individuals possess, which are valuable for economic production.

Relationship to Poverty and Inequality:

- Poverty Reduction: Investing in human capital (e.g., education, healthcare) can lead to increased productivity and earning potential, potentially reducing poverty.
- Inequality: Unequal access to education and healthcare can exacerbate income inequality, as those with more human capital may earn significantly more than those with less.

Measurement:

A. Years of Schooling: A common measure of human capital, reflecting the level of education attained.

B. Skills and Knowledge: Assessed through various tests and assessments.

C. Health Status: Measured by life expectancy, infant mortality rates, and other health indicators.

Difference Between Poverty and Income Inequality

Poverty and income inequality are two different concepts but related in nature; both influence the socio-economic conditions of a society in different ways. Interrelated but very distinct, these aspects of economic and social inequalities relate to and complement each other.

Aspect	Poverty	Income Inequality
Definition	Refers to the condition where individuals lack sufficient resources to meet basic needs.	Refers to the uneven distribution of income and wealth among individuals or groups in a society.
Measurement	Measured using poverty lines, headcount ratios, and poverty gap indices to determine the proportion of people living below a set threshold.	Measured using indices such as the Gini coefficient, Lorenz curve, and Palma ratio to quantify disparities in income distribution.
Focus	Focuses on identifying and quantifying the number of people who are unable to meet their basic needs.	Focuses on the distribution of income and wealth across different segments of the population and the extent of disparities.
Type of Measurement	Absolute measure (absolute poverty) or relative measure (relative poverty) based on income thresholds.	Relative measure that assesses how income or wealth is distributed in comparison to an equal distribution.
Impact on Society	Directly affects individuals' ability to access basic services, impacting their quality of life and overall well-being.	Reflects the broader economic disparities within a society, affecting social cohesion and economic mobility.
Interventions	Typically addressed through poverty alleviation programs such as social safety nets, subsidies, and direct financial assistance.	Addressed through policies aimed at reducing income disparities, such as progressive taxation, minimum wage laws, and wealth redistribution.
Examples	A household living below the poverty line, unable to afford adequate food, clothing, or shelter.	A society where the top 10% of earners have a significantly larger share of total income compared to the bottom 40%.

CAUSES OF INEQUALITY

Inequality, encompassing various forms like economic, social, and political, arises from a complex interplay of factors, including historical injustices, unequal access to resources, discriminatory practices, and systemic biases, leading to disparities in opportunities and outcomes.

1. Economic Inequality:

A. **Income and Wealth Disparities:** Uneven distribution of income and wealth is a primary driver of inequality, creating a gap between the rich and the poor.

B. **Unequal Access to Resources:** Disparities in access to education, healthcare, and other essential resources exacerbate existing inequalities.

C. **Labor Market Issues:** Unemployment, low wages, and precarious employment conditions contribute to economic inequality.

D. **Technological Change:** Automation and other technological advancements can lead to job displacement and wage stagnation, widening the income gap.

E. **Globalization and Trade:** Uneven benefits from globalization and trade can further concentrate wealth and power in the hands of a few.

F. **Tax Policies:** Tax policies that favor the wealthy or allow loopholes can exacerbate income inequality.

G. **Financialization:** The increasing role of finance in the economy can lead to greater wealth concentration and instability.

2. Social Inequality:

a) **Historical Injustices:** Systemic discrimination based on race, ethnicity, gender, religion, or other factors can create lasting inequalities.

b) **Social Stratification:** Societal structures that assign different status and opportunities based on social class or other factors can perpetuate inequality.

c) **Discrimination:** Discrimination in employment, housing, and other areas can limit opportunities for marginalized groups.

d) **Lack of Representation:** Underrepresentation of certain groups in decision-making positions can lead to policies that further marginalize them.

e) **Health Inequalities:** Differences in health status and access to healthcare based on socioeconomic factors.

f) **Educational Inequalities:** Unequal access to quality education and opportunities for learning.

3. Political Inequality:

I. **Unequal Political Power:** Disparities in political influence and representation can lead to policies that favor certain groups over others.

II. **Corruption and Lack of Transparency:** Corruption and lack of accountability can divert resources and undermine democratic processes, exacerbating inequality.

III. **Weak Governance:** Poor governance and weak institutions can create an environment where inequality thrives.

4. Other Factors:

1. **Climate Change:** The effects of climate change can disproportionately impact vulnerable populations, exacerbating existing inequalities.
2. **Conflict and Instability:** Conflict and instability can disrupt economies and social structures, leading to greater inequality.
3. **Migration:** Mass migration can strain resources and create tensions, potentially leading to social and economic inequalities.

THE HUMAN CAPITAL APPROACH EDUCATION AND DEVELOPMENT

The human capital approach views education and development as investments that enhance an individual's skills, knowledge, and abilities, leading to increased productivity and economic growth.

What is Human Capital?

- ❖ Human capital refers to the stock of knowledge, skills, and other personal characteristics embodied in people that help them be productive.
- ❖ It's an intangible asset that individuals and societies can develop and use to enhance their economic productivity and overall well-being.
- ❖ It includes factors like education, training, health, and experience.

The Human Capital Approach to Education:

a) **Investment Perspective:** The human capital approach views education as an investment, similar to investing in physical capital, where the returns are higher earnings and productivity.

b) **Increased Productivity:** Education and training are seen as means to acquire skills and knowledge, which in turn, increase an individual's productivity and value in the workforce.

c) **Economic Growth:** A well-educated and skilled workforce is crucial for economic growth and development.

d) **Social and Economic Benefits:** Investments in education and human capital development can lead to reduced poverty, improved health outcomes, and increased opportunities for individuals and societies.

Key Components of Human Capital Formation:

- ➢ **Formal Education:** Schools, universities, and vocational training programs are key components.
- ➢ **On-the-job Learning:** Practical experience and training on the job contribute to skill development.
- ➢ **Continuous Skill Development:** Staying up-to-date with new technologies and skills is crucial for maintaining productivity.
- ➢ **Health and Well-being:** Good health is also considered an important component of human capital, as it allows individuals to be productive and contribute to society.

SOCIAL AND PRIVATE BENEFITS OF EDUCATION

Education provides both private benefits, directly benefiting the individual, and social benefits, benefiting society as a whole, including economic growth, reduced crime, and improved health outcomes.

Private Benefits of Education:

- **Personal Development:** Education fosters critical thinking, problem-solving skills, and lifelong learning habits, leading to personal growth and enhanced capabilities.
- **Improved Health:** Studies show that higher education is associated with better health outcomes, including increased longevity and reduced risk of certain diseases.
- **Higher Earnings and Job Opportunities:** Education leads to better job prospects and higher earning potential, contributing to improved financial stability.
- **Enhanced Social Status:** Education can lead to increased social standing and influence within a community.
- **Personal Fulfillment:** Education can provide individuals with a sense of purpose and satisfaction, leading to a richer and more meaningful life.

Social Benefits of Education:

- **Economic Growth:** An educated workforce is more productive and innovative, driving economic growth and development.
- **Reduced Crime:** Studies suggest that higher levels of education are associated with lower crime rates.
- **Improved Health Outcomes:** An educated populace is more likely to make informed decisions about healthcare and preventative measures, leading to better overall health.
- **Greater Social Equality:** Education can help to level the playing field and promote social mobility, creating a more just and equitable society.

- **Stronger Democracies:** An educated citizenry is more likely to participate in democratic processes and hold leaders accountable.
- **Sustainable Development:** Education plays a crucial role in addressing social, environmental, and economic challenges, promoting sustainable development.
- **Reduced Welfare Costs:** A more educated workforce is less likely to be unemployed or reliant on social welfare programs.

EDUCATION , INEQUALITY AND POVERTY

Education inequality and poverty are deeply intertwined, with poverty limiting access to quality education and education inequality perpetuating cycles of poverty, hindering social and economic mobility.

How Poverty Hinders Education:

I. **Limited Resources:** Families in poverty often struggle to afford basic necessities, leaving little for education-related expenses like school supplies, uniforms, and extracurricular activities.

II. **Health Issues:** Poor health, common in impoverished communities, can lead to school absenteeism and reduced learning capacity.

III. **Nutrition:** Malnutrition, prevalent in poverty-stricken areas, negatively impacts a child's ability to learn and concentrate.

IV. **Child Labor:** Children from impoverished families may be forced to work instead of attending school to contribute to household income.

V. **Unstable Housing:** Frequent moves and unstable housing conditions can disrupt a child's education and create a sense of insecurity.

VI. **Lack of Access to Quality Education:** Poverty-stricken areas often have underfunded schools, inadequate resources, and less experienced teachers, further exacerbating educational inequalities.

VII. **Discrimination and Bias:** Children from marginalized groups, often facing socioeconomic disparities, may encounter discriminatory practices and biases within the school system.

How Education Inequality Perpetuates Poverty:

a) **Limited Economic Opportunities:** Individuals with limited or poor-quality education are less likely to find well-paying jobs, contributing to a cycle of poverty.

b) **Reduced Social Mobility:** Education inequality can lead to a lack of social mobility, where individuals are trapped in their socioeconomic status due to limited opportunities.

c) **Intergenerational Poverty:** Poverty and lack of education can create a cycle that is passed down through generations, as children inherit the same disadvantages as their parents.

d) **Reduced Economic Growth:** A society with high levels of education inequality may experience slower economic growth and development, as the talents and potential of marginalized groups are not fully utilized.

e) **Social Stratification:** Education inequality can reinforce social stratification, where certain groups are systematically disadvantaged and excluded from opportunities.

Addressing the Issue:

a) **Investing in Early Childhood Education:** High-quality early childhood education programs can help to narrow the achievement gap between children from different socioeconomic backgrounds.

b) **Providing Adequate Resources to Schools:** Ensuring that all schools, regardless of location or socioeconomic status, have access to adequate resources, qualified teachers, and updated facilities is crucial.

c) **Addressing Health and Nutrition Needs:** Providing access to healthcare and ensuring that children have access to nutritious food can improve their ability to learn.

d) **Promoting Inclusive Education Policies:** Implementing policies that address discrimination and bias in schools and ensure that all students have equal opportunities to succeed is essential.

e) **Empowering Marginalized Communities:** Supporting marginalized communities and providing them with the resources and opportunities they need to thrive can help to break the cycle of poverty and inequality.

f) **Promoting Universal Free Education:** Universal free education can enhance people's earning power and can bring them out of poverty.

WOMENS EDUCATION AND DEVELOPMENT

Women's education is crucial for individual and national development, leading to improved health, economic empowerment, and social progress, ultimately contributing to more stable and resilient societies.

Individual Benefits:

- ❖ **Empowerment and Agency:**
- ❖ Education equips women with knowledge, skills, and confidence to make informed decisions about their lives, careers, and futures.
- ❖ **Improved Health and Well-being:**
- ❖ Educated women are more likely to seek healthcare, practice family planning, and make healthy choices for themselves and their children.
- ❖ **Increased Income and Economic Independence:**
- ❖ Education opens doors to better job opportunities and higher earning potential, contributing to financial stability and independence.
- ❖ **Reduced Early Marriage and Childbearing:**
- ❖ Educated women tend to marry later and have fewer children, leading to improved maternal and child health outcomes.
- ❖ **Reduced Gender-Based Violence:**

- ❖ Education can help challenge harmful social norms and attitudes that contribute to violence against women.

Societal Benefits:

- ➢ **Economic Growth:** A more educated workforce, including women, drives economic growth and development.
- ➢ **Reduced Poverty:** When women are educated and economically empowered, they are better able to lift their families and communities out of poverty.
- ➢ **Improved Health Outcomes:** Educated women are better equipped to make informed decisions about their health and the health of their children, leading to lower infant and maternal mortality rates.
- ➢ **Increased Social Stability:** Education fosters a more inclusive and equitable society where all individuals can participate and contribute.
- ➢ **Better Governance:** Educated women are more likely to participate in political processes and hold leaders accountable.
- ➢ **Reduced Inequality:** Education is a powerful tool for reducing gender inequality and promoting social justice.

HEALTH SYSTEM IN DEVELOPMENT

In developing health systems, a focus on building strong foundations, including governance, workforce, and infrastructure, is crucial, with the goal of ensuring equitable, resilient, and efficient care for all, while also promoting health equity and addressing social determinants of health.

1. Core Principles and Goals:

a) **Equity:** Ensuring that everyone, regardless of their socioeconomic status or location, has access to quality healthcare.

b) **Resilience:** Building systems that can withstand shocks and maintain essential functions, such as pandemics or natural disasters.

c) **Efficiency:** Optimizing resource utilization to achieve the best possible health outcomes.

d) **Sustainability:** Designing systems that can function effectively in the long term, considering financial, human, and environmental resources.

e) **Focus on Primary Health Care:** Strengthening primary care as the foundation of the health system, with a focus on prevention, early detection, and management of common health problems.

2. Key Elements of a Strong Health System:

1. **Governance:** Establishing clear roles and responsibilities for different actors, including government, healthcare providers, and communities.
2. **Human Resources:** Ensuring an adequate and well-trained workforce, including doctors, nurses, and community health workers.
3. **Infrastructure:** Providing access to essential infrastructure, such as hospitals, clinics, and transportation networks.
4. **Financing:** Developing sustainable and equitable financing mechanisms, such as social health insurance or tax-based funding.
5. **Information Systems:** Implementing robust data collection and analysis systems to monitor health outcomes and inform decision-making.
6. **Supply of Medicines and Technologies:** Ensuring access to essential medicines and technologies, while managing costs and promoting quality.
7. **Public Health:** Strengthening public health programs to prevent diseases and promote health.

3. Challenges in Developing Health Systems:

a) **Resource Constraints:** Limited financial, human, and infrastructure resources can hinder the development of strong health systems.

b) **Inequities:** Addressing health disparities and ensuring that marginalized populations have access to care.

c) **Political Instability:** Political instability and conflicts can disrupt health systems and undermine development efforts.

d) **Weak Governance:** Lack of effective leadership and coordination can lead to inefficiencies and poor outcomes.

e) **Lack of Data:** Insufficient data can make it difficult to monitor progress and identify areas for improvement.

4. Strategies for Health System Development:

- **Strengthening Primary Health Care:** Investing in primary care services and community health workers.
- **Improving Access to Care:** Addressing geographic and socioeconomic barriers to accessing healthcare.
- **Investing in Human Resources:** Training and retaining healthcare workers, especially in underserved areas.
- **Strengthening Governance:** Establishing clear roles and responsibilities, promoting transparency and accountability.
- **Promoting Health Equity:** Addressing social determinants of health and ensuring that marginalized populations have access to care.
- **Building Resilience:** Preparing for and responding to shocks, such as pandemics or natural disasters.
- **Using Data to Inform Decision-Making:** Implementing robust data collection and analysis systems.

HEALTH AND PRODUCTIVITY

Strong health, both physical and mental, directly correlates with increased productivity, as healthy individuals are more energetic, less prone to illness, and better able to focus and perform tasks efficiently.

How Health Impacts Productivity:

- ❖ **Reduced Absenteeism:** Healthy employees are less likely to call in sick, leading to fewer disruptions in workflow and increased output.
- ❖ **Improved Focus and Concentration:** Good health, especially mental health, allows for better cognitive function, leading to improved focus and concentration, which are crucial for productivity.
- ❖ **Increased Energy Levels:** Physical and mental health contribute to higher energy levels, allowing individuals to work more efficiently and for longer periods.
- ❖ **Reduced Stress and Burnout:** Healthy habits, like regular exercise and a balanced diet, can help reduce stress and prevent burnout, which can significantly impair productivity.
- ❖ **Enhanced Problem-Solving Skills:** Good mental health can lead to improved problem-solving skills, allowing individuals to tackle challenges more effectively and efficiently.
- ❖ **Improved Decision-Making:** Healthy individuals are often better equipped to make sound decisions, contributing to better overall performance and productivity.
- ❖ **Better Work-Life Balance:** Prioritizing health can lead to a better work-life balance, which can further enhance productivity by reducing stress and improving overall well-being.

Strategies to Promote Health and Productivity:

- ➢ **Encourage Healthy Habits:** Promote healthy eating, regular exercise, and sufficient sleep through company initiatives and resources.
- ➢ **Prioritize Mental Health:** Provide access to mental health resources, support programs, and promote a culture of open communication about mental health.
- ➢ **Optimize the Workplace Environment:** Ensure a comfortable and ergonomic workspace, with good lighting, temperature control, and access to fresh air.

- **Offer Flexible Work Arrangements:** Consider offering flexible work arrangements, such as remote work options or flexible hours, to help employees better manage their work and personal lives.
- **Promote Breaks and Recreation:** Encourage employees to take regular breaks and engage in activities that promote relaxation and well-being.
- **Provide Resources for Wellness:** Offer resources and programs that promote health and wellness, such as fitness classes, healthy eating workshops, or stress management training.
- **Recognize and Reward Healthy Behaviors:** Acknowledge and reward employees who demonstrate healthy behaviors and contribute to a positive and productive work environment.

FINANCING HEALTH SYSTEM IN DEVELOPING ECONOMICS

Financing health systems in developing economies faces challenges like limited resources, inequitable access, and reliance on out-of-pocket payments, requiring innovative strategies to ensure universal health coverage.

Challenges:

a) **Limited Resources:** Developing countries often struggle with insufficient public funding for healthcare, leading to understaffed facilities, shortages of essential medicines, and poor infrastructure.

b) **Inequitable Access:** High out-of-pocket payments can create a financial barrier to accessing healthcare, disproportionately affecting low-income populations and exacerbating health inequalities.

c) **Dependence on External Aid:** Reliance on donor funding can be unsustainable and may not align with national priorities or needs.

d) **Inefficient Resource Allocation:** Lack of proper planning and management can lead to wastage and suboptimal use of available resources.

Strategies for Improvement:

1. **Increase Public Spending:**Governments need to prioritize health spending and allocate a larger share of their budgets to healthcare.
2. **Diversify Funding Sources:** Explore alternative funding mechanisms, such as social health insurance, payroll taxes, and user fees (with safeguards to ensure equity), to reduce reliance on out-of-pocket payments.
3. **Strengthen Health Financing Systems:** Implement robust systems for revenue collection, pooling of funds, and purchasing of services to ensure efficient and equitable resource allocation.
4. **Prioritize Primary Healthcare:** Invest in strengthening primary healthcare services, which are the foundation of any effective health system and can help prevent diseases and promote health.
5. **Promote Evidence-Based Decision-Making:** Use data and research to inform health financing policies and ensure that resources are allocated effectively.
6. **Strengthen Health Accounts:** Establish and institutionalize robust health accounts to guide policymakers in proper allocation of funds.
7. **Focus on Equity and Social Protection:** Implement policies that ensure financial protection against catastrophic healthcare costs and promote equitable access to services for all, regardless of income or location.
8. **Strengthen Human Resources for Health:** Invest in training and retaining healthcare professionals to ensure that there are enough qualified staff to deliver quality care.
9. **Promote Partnerships:** Foster partnerships between governments, NGOs, private sector, and international organizations to leverage resources and expertise.
10. **Utilize Technology:** Explore the use of digital technologies to improve access to healthcare services and reduce costs.

GENDER PERSPECTIVE IN HEALTHCARE

A "gender perspective in healthcare" means considering how gender roles, norms, and power dynamics influence health outcomes, access to care, and experiences of individuals, aiming to address inequalities and improve health equity.

What it is:

A gender perspective in healthcare recognizes that gender is a social construct that shapes people's lives and experiences, including their health. It goes beyond simply looking at biological sex and considers how gender roles, norms, and power dynamics affect health.

Why it's important:

Ignoring gender can lead to healthcare disparities and inequities, as different groups may have different needs, experiences, and barriers to accessing care.

Examples of gendered health issues:

- ❖ **Reproductive health:** Women's reproductive health needs are often overlooked or stigmatized, leading to poor outcomes.
- ❖ **Mental health:** Gender roles and societal expectations can impact mental health, with women often facing higher rates of depression and anxiety.
- ❖ **Cardiovascular disease:** While cardiovascular disease is often seen as a "male" problem, women experience it differently, with different symptoms and outcomes.
- ❖ **Violence:** Gender-based violence, including intimate partner violence and sexual violence, has significant health consequences, and healthcare providers must be aware of these issues and provide appropriate care.

How to integrate a gender perspective:

1. **Training healthcare providers:** Healthcare professionals need to be educated about gender, gender roles, and how they impact health.
2. **Collecting gender-specific data:** Data collection should include gender, not just sex, to understand health disparities and tailor interventions accordingly.

3. **Challenging gender stereotypes:** Healthcare providers should be aware of and challenge gender stereotypes that can lead to biased diagnoses and treatments.

4. **Empowering individuals:** Healthcare should be focused on empowering individuals to make informed decisions about their health and bodies.

Benefits:

Integrating a gender perspective in healthcare can lead to:

- Improved health outcomes for all.
- Reduced health inequities.
- More effective and equitable healthcare services.

UNIT – IV

AGRICULTURE AND RURAL DEVELOPMENT

Agriculture and rural development are intertwined, with the latter aiming to improve the social and economic well-being of rural communities, often through agricultural advancements and related infrastructure.

Key Concepts and Connections:

- **Rural Development:**

This encompasses strategies to improve the quality of life and economic prospects of people living outside urban areas, often focusing on agriculture and related industries.

- **Agriculture's Role:**

Agriculture is a primary livelihood for many rural populations, and its productivity and sustainability are crucial for rural development.

- **Poverty and Food Security:**

A significant portion of the world's poor reside in rural areas, and many depend on agriculture for their livelihoods. Enhancing agricultural productivity is essential to address poverty and food insecurity.

- **Challenges in Rural Areas:**

Rural areas often face challenges like limited access to infrastructure (roads, electricity, internet), healthcare, and education, as well as vulnerability to climate change and economic shocks.

- **Sustainable Development:**

Rural development initiatives increasingly emphasize sustainable practices in agriculture and resource management to ensure long-term viability and environmental protection.

- **Economic Diversification:**

Promoting economic diversification beyond agriculture, such as through tourism, handicrafts, or other rural industries, can enhance the resilience of rural communities.

- **Government Initiatives:**

Governments play a crucial role in supporting rural development through policies, programs, and investments in infrastructure and agricultural technologies.

- **International Organizations:**

International organizations like the International Fund for Agricultural Development (IFAD) and the World Bank play a significant role in supporting rural development projects and research worldwide.

- **India's Context:**

In India, the Ministry of Agriculture and Farmers' Welfare and the Ministry of Rural Development are key players in promoting agricultural development and rural welfare.

- **NABARD:**

The National Bank for Agriculture and Rural Development (NABARD) plays a crucial role in providing financial services and support to the agricultural sector and rural development initiatives.

THE ROLE OF AGRICULTURE IN DEVELOPMENT

Agriculture plays a vital role in development by providing food security, supporting livelihoods, driving economic growth, and fostering social stability, particularly in developing nations.

1. Food Security and Nutrition:

- Agriculture is the foundation of food systems, ensuring the availability and accessibility of food for the population.
- Increased agricultural productivity leads to better nutrition and improved health outcomes.
- Sustainable agriculture practices are crucial for long-term food security and environmental sustainability.

2. Economic Growth and Employment:

- Agriculture is a major economic pillar in many developing countries, contributing significantly to GDP and employment.
- Increased agricultural productivity leads to higher incomes for farmers and rural communities.
- Agriculture provides raw materials for various industries, driving industrial growth and creating further employment opportunities.

3. Social Stability and Rural Development:

- Agriculture plays a crucial role in rural development, providing livelihoods and reducing poverty.
- By empowering small-scale farmers, agriculture can contribute to social equity and stability.
- Investing in rural infrastructure and agricultural technologies can improve the quality of life in rural areas.

4. Environmental Sustainability:

- Sustainable agriculture practices are essential for maintaining healthy ecosystems and ensuring long-term resource availability.
- Adopting climate-smart agriculture can help mitigate the impacts of climate change and build resilience in agricultural systems.
- Promoting biodiversity and protecting natural resources is crucial for sustainable agricultural development.

5. Technological Advancements and Innovation:

- Agricultural research and development are vital for improving crop yields, developing drought-resistant varieties, and enhancing food quality.
- Technological advancements in agriculture, such as precision farming and biotechnology, can contribute to increased productivity and efficiency.

- Innovation in agriculture is crucial for addressing the challenges of food security and climate change.

AGRICULTURAL POLICY

Agricultural policy encompasses a set of laws and regulations concerning domestic agriculture and imports of foreign agricultural products, aiming to achieve specific outcomes in the domestic agricultural market.

Definition:

Agricultural policy refers to the policies and regulations implemented by governments to influence the agricultural sector, including production, trade, and consumption of agricultural products.

Goals:

Governments often implement agricultural policies to achieve various goals, such as:

1. Ensuring food security and affordability.
2. Supporting farmers' incomes and livelihoods.
3. Promoting sustainable agricultural practices.
4. Regulating international trade in agricultural products.

Examples of Agricultural Policies:

A. **Subsidies:** Governments may provide financial assistance to farmers to help them cover costs, such as input costs (seeds, fertilizers, etc.) or production costs.

B. **Price support mechanisms:** Minimum support prices (MSPs) or other price guarantees can be implemented to ensure farmers receive a certain level of income.

C. **Trade policies:** Tariffs, quotas, and other trade barriers can be used to protect domestic agricultural producers from foreign competition.

D. **Land use regulations:** Policies can be implemented to regulate land use, such as preventing the conversion of agricultural land to other uses.

E. **Environmental regulations:** Policies can be implemented to promote sustainable agricultural practices, such as reducing pesticide use or promoting water conservation.

Examples of Agricultural Schemes in India:

1. **Pradhan Mantri KISAN Samman Nidhi (PM-KISAN):** A scheme providing income support to farmers.
2. **Pradhan Mantri Fasal Bima Yojana (PMFBY):** A crop insurance scheme for farmers.
3. **Pradhan Mantri Krishi Sinchayee Yojana (PMKSY):** A scheme to enhance irrigation and improve water management.
4. **Paramparagat Krishi Vikas Yojana (PKVY):** A scheme to promote organic farming.
5. **E-NAM (National Agriculture Market):** An online platform for agricultural commodity trading

PRICING POLICY - RISK AVERSION AND UNCERTAINTY IN SUBSISTENCE FARMING

In subsistence farming, where farmers primarily farm for their own consumption, pricing policies and market uncertainties are less crucial than yield and resource variability, leading to high risk aversion. Farmers prioritize strategies to ensure survival and minimize risk rather than maximizing profits.

- **Focus on Yield and Resource Uncertainty:**

Subsistence farmers are primarily concerned with securing enough food for their families, so yield variability (due to weather, pests, etc.) and resource availability (land, water, etc.) are the most significant risks.

- **Limited Market Involvement:**

Subsistence farmers often have minimal contact with formal markets, meaning input and output price fluctuations are less relevant than the direct impact on their ability to produce food.

- **Risk Aversion:**

Due to the high stakes of their livelihood, subsistence farmers tend to be highly risk-averse, meaning they prefer stable, predictable outcomes over potentially higher but uncertain gains.

- **Decision-Making Strategies:**

Risk aversion influences their decision-making, leading them to:

1. **Diversify crops:** Planting a variety of crops reduces the risk of complete crop failure due to a specific issue affecting one crop.
2. **Prioritize traditional methods:** They may be less inclined to adopt new technologies or farming practices that could increase risk, even if they offer potential benefits.
3. **Focus on self-sufficiency:** They may prioritize producing their own food rather than specializing in a single crop for sale.

Impact of Government Policies:

Government policies, such as price controls or subsidies, can have a limited impact on subsistence farmers as they are less reliant on market prices.

Importance of Risk Management:

Despite the limited market involvement, subsistence farmers still need to manage risks effectively. This includes diversifying crops, using drought-resistant varieties, and developing strategies for coping with crop failures.

RURAL-TO-URBAN MIGRATION

Rural-to-urban migration refers to the movement of people from rural areas to urban areas, often driven by the pursuit of better opportunities like employment, education, and a higher quality of life.

Definition:

Rural-to-urban migration is the movement of people from rural (less populated) areas to urban (more populated) areas, either temporarily or permanently.

Types:

This migration can occur at both national and international levels, but internal or national migration is more common.

Urbanization:

It's a key factor in the process of urbanization, where the population of cities grows and urban areas expand.

Reasons for Migration:

1) **Push Factors (Reasons to leave rural areas):**
   a) **Poverty and Lack of Basic Amenities:** Rural areas often have limited economic opportunities and lack access to essential services like healthcare, education, and infrastructure.
   b) **Overpopulation and Environmental Deterioration:** Overpopulation and environmental degradation in rural areas can lead to resource scarcity and a lower quality of life.
2) **Pull Factors (Reasons to move to urban areas):**
   1. **Job Opportunities:** Cities typically offer more and better job opportunities, which can lead to higher wages and a better standard of living.
   2. **Higher Wages:** Urban areas often have higher wages and salaries compared to rural areas.
   3. **Better Living Conditions:** Cities may offer access to better infrastructure, healthcare, education, and entertainment.
   4. **Bright-light theory:** The allure and attraction of the city can also be a significant factor.

Examples:

India:

A large number of people migrate from rural areas to cities in India, seeking employment and a better quality of life.

Global Phenomenon:

Rural-to-urban migration is a global phenomenon, with significant impacts on both rural and urban areas.

Consequences:

1. **Urban Growth:** Rural-to-urban migration leads to the growth of urban populations and the development of new urban communities.
2. **Strain on Resources:** The influx of people into cities can put a strain on urban infrastructure, housing, and resources.
3. **Rural Depopulation:** Migration can lead to the depopulation of rural areas, impacting local economies and social structures.
4. **Competition for Resources:** The increased population in urban areas can lead to competition for jobs, housing, and other resources.

THE TODARO MODEL

The Todaro model, also known as the Harris-Todaro model, explains rural-urban migration by focusing on expected income differentials rather than just wage differentials, suggesting migration is rational even with high urban unemployment, as people weigh potential gains against costs.

Core Idea:

The model posits that individuals migrate from rural to urban areas based on a comparison of their expected incomes in each sector, not just the actual wages.

Expected Income:

This means migrants consider the probability of finding a job in the urban area, and the potential wage if they do, alongside the costs of migration.

Rational Decision-Making:

Even with high urban unemployment, migration can be economically rational if the expected urban income (including the probability of finding a job) exceeds the rural income.

Equilibrium:

The model suggests that migration continues until the expected income in the urban sector equals the rural income, creating an equilibrium where the flow of migrants stabilizes.

Implications:

The model highlights the importance of considering both wages and employment opportunities when analyzing migration patterns, particularly in developing countries where urban unemployment is common.

Criticisms and Extensions:

The model has been criticized for its simplicity and for not fully accounting for factors like social networks and non-economic motivations for migration. Extensions of the model have addressed some of these limitations.

The **Harris–Todaro model**, named after John R. Harris and Michael Todaro, is an economic model developed in 1970 and used in development economics and welfare economics to explain some of the issues concerning rural-urban migration. The main assumption of the model is that the migration decision is based on *expected* income differentials between rural and urban areas rather than just wage differentials. This implies that rural-urban migration in a context of high urban unemployment can be economically rational if expected urban income exceeds expected rural income.

In the model, an equilibrium is reached when the expected wage in urban areas (actual wage adjusted for the unemployment rate), is equal to the marginal product of an agricultural worker. The model assumes that unemployment is non-existent in the rural agricultural sector. It is also assumed that rural agricultural production and the subsequent labor market is perfectly competitive. As a result, the agricultural rural wage is equal to agricultural marginal productivity. In equilibrium, the rural to urban migration rate will be zero since the expected rural income equals the expected urban income. However, in this equilibrium there will be positive unemployment in the urban sector. The model explains internal migration in China as the regional income gap has been proved to be a primary drive of rural-urban migration, while urban unemployment is local governments' main concern in many cities.

Therefore, migration from rural areas to urban areas will increase if:

- Wages increase in the urban sector, increasing the expected urban income.
- Agricultural productivity decreases, lowering marginal productivity and wages in the agricultural sector (w_A), decreasing the expected rural income.

However, even though this migration creates unemployment and induces informal sector growth, this behavior is economically rational and utility-maximizing in the context of the Harris–Todaro model. As long as the migrating economic agents have complete and accurate information concerning rural and urban wage rates and probabilities of obtaining employment, they will make an expected income-maximizing decision.

RURAL CREDIT

Rural credit is a financial mechanism designed to provide financial support to individuals, farmers, and businesses in rural areas. This type of credit is essential for fostering agricultural development, promoting rural entrepreneurship, and improving the overall economic well-being of rural communities. Access to rural credit allows farmers to invest in seeds, equipment, and technology, empowering them to enhance productivity and contribute to the growth of the agricultural sector. The subject of rural credit UPSC covers the significance of extending finance to farmers and rural societies for improving agricultural productivity and economic growth.

What is Rural Credit?

Rural credit is the finance that farmers and villagers borrow in order to assist them with farming or business. It is used to purchase seeds, tools, or machinery necessary for farming. This credit facilitates better farming so that farmers produce more crops and earn more money. Rural credit is significant as it assists rural dwellers to access money that they use to better their lives. It may be from various sources such as banks, co-operative societies, or even moneylenders.

INSTITUTIONAL SOURCES OF RURAL CREDIT

Institutional sources of rural credit are government institutions such as banks and co-operatives which lend money to farmers and individuals in rural regions. These institutions assist individuals to access financial support for agriculture, business, and better living standards.

1. **Commercial Banks** Commercial banks are large banks that provide loans to farmers and rural individuals for agriculture and other purposes. They provide loans at varying interest rates to enable people to purchase seeds,

tools, and machinery. The loans enhance agriculture and businesses in villages. Commercial banks contribute significantly to the development of rural communities.

2. **Co-operative Banks** Co-operative banks are unique banks owned by individuals belonging to the same community or group, usually in rural communities. They provide loans to small businesses and farmers at reduced interest rates. The objective of co-operative banks is to assist the local population and develop the economy of their community. Co-operative banks play a very significant role in offering cheap credit to rural communities.
3. **Regional Rural Banks (RRBs)** Regional Rural Banks (RRBs) are government-established banks that provide rural people with financial assistance. RRBs lend loans to farmers at low interest rates, thus facilitating easy development of their farms. RRBs concentrate on assisting rural people, particularly farmers, in developing their crops and businesses. RRBs assist in making the economy stronger in villages by supplying credit.
4. **NABARD (National Bank for Agriculture and Rural Development)** NABARD is a government agency that assists farmers and rural communities through loans and financial guidance. It funds projects that enhance agricultural and rural development. NABARD also assists banks and other agencies in ensuring that farmers receive the appropriate type of credit. It contributes significantly to enhancing the lives of rural people by assisting them in accessing the resources they require.

OBJECTIVES OF RURAL CREDIT

The primary aim of rural credit is to assist farmers and villagers in accessing money to develop their farms or establish small businesses. It assists rural development through the financial capital required for expansion and higher living standards.

- **To Facilitate Agricultural Operations**

One major goal of rural credit is to enable farmers to purchase seeds, equipment, and farming tools. Farmers can use loans to produce more crops, enrich the soil, or purchase machines to conduct better farming. With this access to funds, farmers can raise their production level. This will result in additional food and revenues for the farmers and society at large.

- **To Encourage Small Businesses**

Rural credit is also beneficial for individuals living in villages to commence or develop small enterprises. Loans enable them to purchase commodities, construct stalls, or enhance businesses. These small enterprises bring forth additional job opportunities and support local economic improvement. This is used to diminish rural poverty since people have better prospects of obtaining incomes.

- **For the Purposes of Increasing Rural People's Livelihood Standard**

Rural credit seeks to enhance the standard of living in villages by offering financial assistance for different purposes. Individuals can take loans for education, medical care, and constructing improved homes. Credit enables families to satisfy their basic needs and enjoy healthier, happier lives.

- **To Lessen Reliance on Informal Lenders**

One of the key aims of rural credit is to reduce people's dependence on high-interest moneylenders. Rural credit allows individuals to access low-interest loans from banks and co-operative societies and enables them to get the support they need without falling into debt. It makes it easy for individuals to get money at an affordable price to improve their living. It keeps individuals away from falling into debt traps with moneylenders.

NEED OF RURAL CREDIT

There is a need for rural credit because most farmers and villagers do not have sufficient funds to purchase the equipment and materials they require for farming or operating a small business. Rural credit enables them to acquire the financial assistance they need to enhance their activities and earn a decent living.

- **For Better Farming**

  Farmers require rural credit to purchase seeds, fertilizers, equipment, and machinery for agriculture. Without loans, most farmers are unable to purchase these essential items. With credit, they are able to produce more crops and earn more income. This enables them to feed their families and the community.

- **To Start or Expand Small Businesses**

  Rural credit is also required for individuals who wish to start or grow small enterprises in villages. They might require funds to purchase commodities, machinery, or open a shop. By taking loans, they can develop their business and employ others. This enhances the local economy and offers greater prospects for rural dwellers.

- **To Overcome Seasonal Problems**

  Farmers are usually subjected to weather conditions, like droughts or floods, that destroy their crops. Rural credit enables them to take loans during those difficult periods in order to purchase seeds, implements, or even feed for animals. This assistance enables them to bounce back from poor seasons and remain productive. It allows farmers to maintain their farms even when times are not good.

- **To Decrease Moneylender Dependence**

  Most people in villages borrow money from local moneylenders at very high-interest rates. Rural credit decreases this dependence by availing loans at reasonable interest rates. This enables individuals to borrow money without being caught up in debt. It assists farmers and others in the village to better their lives without fear of high charges.

PROBLEMS OF RURAL CREDIT IN INDIA

Most farmers and people in rural villages in India have problems getting credit or loans for their use. Such problems limit them from improving their farming and businesses, hence their growth.

- **Unavailability of Banks**

  Most villages in India lack sufficient banks or financial institutions. This implies that individuals living in rural areas must go for long distances to access loans, which may not be easy. Even if there are banks, the process of accessing loans becomes complex and takes a lot of time. Therefore, most individuals in villages cannot access credit.

- **High-Interest Rates**

  When rural individuals do borrow loans, sometimes the interest rate is extremely high. This will mean that they have to repay much more than they took. This can be difficult for them to do. High interest charges can make it hard for farmers to earn enough to pay the loan back. This issue makes it more challenging for them to enhance their business or farms.

- **Lack of Collateral**

  Banks require collateral, such as land or property, before approving loans. The majority of the farmers and villagers lack sufficient land or property for use as security. Due to this, obtaining loans is difficult for them. This problem restrains their chances of expanding businesses or enhancing agricultural farming.

- **Over-reliance on Informal Sources**

  As access to loans from banks is not easy, many rural folks take loans from neighborhood moneylenders. But even they charge still higher interest and exploit poor peasants. This will make it inconvenient for farmers to make a profit. Relying on them can keep the people trapped in debt and fail to enhance the lives of such people.

RURAL CREDIT AGENCIES IN INDIA

There are various organizations in India which assist farmers and villagers to obtain the finance they require for small business and agriculture. These agencies offer loans and financing to enhance the standard of living of rural people.

- **Commercial Banks**

  Commercial banks are big banks that provide rural residents with loans. They lend money for agriculture, buying seeds, and establishing small-scale business. The loan is provided with fluctuating interest rates depending on the amount given. These banks contribute to increasing the economy of villages by giving people a chance to prosper and develop.

- **Co-operative Banks**

  Co-operative banks are unique banks that are owned by the community they serve, primarily in villages. They provide loans to farmers and small businesses at a low rate of interest. They are a vital component of rural credit as they assist local individuals in accessing the money they require for agriculture and other purposes. Co-operative banks concentrate on assisting people in rural areas to develop and prosper.

- **Regional Rural Banks (RRBs)**

  Regional Rural Banks were established by the government to provide loans to farmers and rural people. RRBs are established in villages and are within easy reach of people. RRBs provide low-interest loans to farmers so that they can cultivate their fields and enhance their farms. RRBs benefit rural people by extending credit which assists people to enhance their enterprises and lives.

- **NABARD (National Bank for Agriculture and Rural Development)**
  NABARD is a special government organization that works to improve agriculture and rural development. It provides loans to banks and financial institutions, who in turn provide loans to farmers and rural people. NABARD

also helps in planning and financing rural schemes. It plays an important role in improving the rural economy and helping farmers get credit.

NON INSTITUTIONAL SOURCES OF RURAL CREDIT

Besides banks, there are also other means by which individuals in rural areas can obtain loans. These are referred to as non-institutional sources since they are not government agencies or official banks.

- **Moneylenders**

  Moneylenders are individuals who provide loans to farmers or villagers against a charge or interest. They usually have very high interest rates, which it is hard for the borrower to pay back. Even though moneylenders are readily available, their loans result in debt issues for the borrower. Individuals tend to seek loans from moneylenders when they are unable to access loans from banks or other formal institutions.

- **Relatives and Friends**

  Most rural individuals take loans from their family members or friends when they require money. The loans can be without any official procedure, and the interest is minimal. But taking loans from friends or relatives can sometimes result in personal issues if the amount is not returned on time. It can also create tension if there is conflict regarding repayment.

- **Landlords**

  Farm landlords occasionally advance loans to their farm workers or tenants. The loans are usually made with the condition that the borrower will work for the landlord or repay the money with interest. Although the loans are more accessible, they make the borrower indebted to the landlord. This imbalances the situation such that the borrower is not able to pay off the loan.

- **Traders and Shopkeepers**

Farmers in rural areas usually obtain credit from shopkeepers or traders to purchase items or supplies. The loans enable farmers to purchase what they want and settle the bill later. Nevertheless, the shopkeepers tend to overcharge for items or include interest in the loan. This makes it difficult for farmers to repay what they borrowed.

ALL INDIA RURAL CREDIT SURVEY COMMITTEE

One of the greatest surprises of the survey was the limited role played by institutional credit sources, including cooperatives and commercial banks, in rural areas. The report noted that the institutions were not penetrating sufficiently into the rural population and that their coverage was not sufficient to satisfy the extensive and diversified credit requirements of rural people. Rural credit is a key component in the provision of financial services for rural communities and the achievement of sustainable economic growth. Through the extension of credit to rural communities, governments, financial institutions, and organizations are able to empower farmers and rural businesspersons. This, subsequently, has various positive effects on the productivity of agriculture, level of income, and general health of rural economies.

UNIT - V

POLICES FOR DEVELOPMENT MARKET AND THE STATE IN DEVELOPMENT

Effective development policies require a balanced approach, recognizing the strengths of both the market and the state. The market's role is in resource allocation, innovation, and economic growth, while the state ensures stability, equity, and provides essential services.

Market-Oriented Policies:

- **Promoting Competition:** Deregulation, privatization, and free trade agreements can foster competition, leading to innovation and efficiency.
- **Supporting Entrepreneurship:** Tax incentives, access to finance, and streamlined regulations can encourage entrepreneurship and investment.
- **Investing in Infrastructure:** Roads, railways, energy grids, and telecommunications are crucial for economic growth and competitiveness.
- **Promoting Trade:** Reducing trade barriers and promoting exports can boost economic growth and create jobs.

State-Led Policies:

- **Ensuring Social Equity:** Progressive taxation, social safety nets, and universal access to healthcare and education can reduce inequality and poverty.
- **Regulating the Market:** Antitrust laws, consumer protection, and environmental regulations can prevent monopolies and protect consumers and the environment.
- **Providing Public Goods:** Infrastructure, education, healthcare, and defense are essential public goods that the state must provide.
- **Managing the Macroeconomy:** Monetary and fiscal policies can stabilize the economy and prevent crises.

- **Promoting Research and Development:** Investing in research and development can lead to technological breakthroughs and economic growth.
- **Coordinating Development:** The state can play a crucial role in coordinating development efforts, ensuring that different sectors and regions benefit from economic growth.
- **Investing in Human Capital:** Education, healthcare, and skills training are essential for a productive workforce.
- **Supporting Small Businesses:** Providing access to finance, training, and mentorship can help small businesses grow and create jobs.
- **Promoting Inclusive Growth:** Ensuring that all segments of society benefit from economic growth, including women, minorities, and marginalized groups.

THE WASHINGTON CONSENSUS COMPONENTS AND CRITICAL EVALUATION

The Washington Consensus, a set of economic policies promoted by the IMF and World Bank, comprises fiscal discipline, deregulation, privatization, trade liberalization, and other measures, but has faced criticism for potentially exacerbating inequality and hindering sustainable development.

Components of the Washington Consensus:

- **Fiscal Discipline:** Reducing government spending and deficits through measures like tax increases or cuts in public spending.
- **Reordering Public Spending Priorities:** Shifting focus from subsidies to areas with high economic returns, such as health and education.
- **Tax Reform:** Simplifying and broadening the tax base to increase revenue.
- **Financial Liberalization:** Allowing market forces to determine interest rates and exchange rates.
- **Liberalization of Trade:** Reducing tariffs and other trade barriers.
- **Permitting Inward Foreign Investment:** Encouraging foreign companies to invest in the country.

- **Privatization:** Selling state-owned enterprises to private companies.
- **Deregulation:** Reducing government regulations to promote competition and efficiency.
- **Secure Property Rights:** Protecting private property rights to encourage investment.

Critical Evaluation of the Washington Consensus:

- **Focus on Economic Growth Over Social Development:** Critics argue that the Washington Consensus prioritizes economic growth over social equity and poverty reduction, potentially leading to increased inequality.
- **Lack of Adaptability to Diverse Contexts:** The "one-size-fits-all" approach of the consensus may not be suitable for all developing countries, as different countries have unique economic and social conditions.
- **Potential for Social Unrest:** The austerity measures often associated with the Washington Consensus, such as cuts in social spending, can lead to social unrest and instability.
- **Dependence on External Aid:** The reliance on external aid and conditional lending from the IMF and World Bank can create a dependency relationship and limit the autonomy of developing countries.
- **Increased Inequality:** Critics argue that the policies of the Washington Consensus, such as deregulation and privatization, have contributed to increased income inequality in many developing countries.
- **Environmental Concerns:** The focus on economic growth without adequate environmental safeguards can lead to unsustainable development practices and environmental degradation.

The **Washington Consensus** is a set of ten economic policy prescriptions considered in the 1980s and 1990s to constitute the "standard" reform package promoted for crisis-wracked developing countries by the Washington, D.C.-based institutions the International Monetary Fund (IMF), World Bank and United States Department of the Treasury. The term was first used in 1989 by English economist John Williamson. The prescriptions encompassed free-market promoting policies such as trade liberalization, privatization and finance liberalization. They also entailed fiscal and monetary policies intended to minimize fiscal deficits and minimize inflation.

Subsequent to Williamson's use of the terminology, and despite his emphatic opposition, the phrase Washington Consensus has come to be used fairly widely in a second, broader sense, to refer to a more general orientation towards a strongly market-based approach (sometimes described as market fundamentalism or neoliberalism). In emphasizing the magnitude of the difference between the two alternative definitions, Williamson has argued that his ten original, narrowly defined prescriptions have largely acquired the status of "motherhood and apple pie" (i.e., are broadly taken for granted), whereas the subsequent broader definition, representing a form of neoliberal manifesto, "never enjoyed a consensus [in Washington] or anywhere much else" and can reasonably be said to be dead.

Discussion of the Washington Consensus has long been contentious. Partly this reflects a lack of agreement over what is meant by the term, but there are also substantive differences over the merits and consequences of the policy prescriptions involved. Some critics take issue with the original Consensus's emphasis on the opening of developing countries to the global marketplace and transitioning to an emerging market in what they see as an excessive focus on strengthening the influence of domestic market forces, arguably at the expense of governance which will affect key functions of the state. For other commentators, the issue is more what is *missing*, including such areas as institution-building and targeted efforts to improve opportunities for the weakest in society through equal opportunity, social justice and poverty reduction.

THE ROLE OF STATE IN DEVELOPMENT

The state plays a crucial role in development by providing essential public goods and services, fostering a conducive environment for economic growth, and promoting social equity through policies and programs.

1. Providing Public Goods and Services:

A. **Infrastructure:** The state is responsible for building and maintaining essential infrastructure like roads, bridges, and utilities, which are crucial for economic activity and social mobility.

B. **Education and Healthcare:** Investing in education and healthcare systems ensures a skilled workforce and a healthy population, both vital for development.

C. **Security and Justice:** A stable and secure environment is essential for investment and economic growth, which the state provides through law enforcement, a functioning judicial system, and national defense.

D. **Social Protection:** The state plays a role in protecting vulnerable populations through social safety nets, unemployment benefits, and other social programs.

2. Fostering Economic Growth:

A. **Sound Regulatory Framework:** The state establishes and enforces laws and regulations that promote fair competition, protect property rights, and ensure the efficient functioning of markets.

B. **Financial Sector Development:** A stable and well-regulated financial sector is essential for mobilizing capital and supporting economic growth.

C. **Investment Promotion:** The state can attract foreign and domestic investment through policies that create a favorable business environment.

D. **Innovation and Technological Advancement:** The state can play a role in promoting innovation and technological advancement through research and development funding, and policies that encourage entrepreneurship.

3. Promoting Social Equity:

A. **Redistribution of Wealth:** The state can use taxation and social programs to redistribute wealth and reduce income inequality.

B. **Empowerment of Marginalized Groups:** The state can implement policies that empower marginalized groups, such as women, ethnic minorities, and people with disabilities.

C. **Environmental Protection:** The state has a responsibility to protect the environment and ensure sustainable development.

D. **Coordination and Synergies:** The state can coordinate the efforts of various actors, including government agencies, NGOs, private businesses, and international organizations, to achieve development goals.

MARKET FAILURE STATE FAILURE AND DEVELOPMENT

Market and state failures, along with their impact on development, are crucial economic concepts. Market failure occurs when the free market fails to allocate resources efficiently, while state failure happens when the government's actions hinder development.

Market Failure:

Definition:

Market failure occurs when the free market mechanism fails to allocate resources efficiently, leading to suboptimal outcomes for society.

Causes:

1. **Externalities:** Costs or benefits of an activity that affect parties not directly involved in the transaction (e.g., pollution).
2. **Public Goods:** Goods that are non-excludable (everyone can benefit) and non-rivalrous (one person's consumption doesn't reduce another's) (e.g., clean air).
3. **Information Asymmetry:** When one party has more information than another, leading to inefficient decisions (e.g., used car market).
4. **Market Power:** When a single entity or a small group can control prices or quantities (e.g., monopolies).

Examples:

A. **Environmental Pollution:** Industries polluting without bearing the full costs, leading to lower overall welfare.

B. **Lack of Infrastructure:** Underinvestment in essential infrastructure like roads or electricity due to externalities.

C. **Inequitable Income Distribution:** Market forces may not lead to a fair distribution of wealth, potentially hindering development.

State Failure:

Definition:

State failure occurs when the government's actions or inactions hinder economic development, often due to corruption, weak institutions, or ineffective policies.

Causes:

A. **Corruption:** Misuse of public resources for personal gain, undermining economic efficiency and development.

B. **Weak Institutions:** Lack of effective legal frameworks, property rights protection, and rule of law.

C. **Ineffective Policies:** Government interventions that distort markets or create inefficiencies.

D. **Rent-Seeking:** Individuals or groups using their political connections to gain economic benefits at the expense of others.

Examples:

1. **Failed Infrastructure Projects:** Corruption and mismanagement leading to incomplete or substandard infrastructure projects.
2. **Unstable Macroeconomic Environment:** Inconsistent policies leading to inflation, high interest rates, or currency instability.
3. **Lack of Social Safety Nets:** Failure to provide basic services like healthcare or education, hindering human capital development.

Impact on Development:

1. **Reduced Economic Growth:** Both market and state failures can lead to lower economic growth, reduced investment, and decreased productivity.
2. **Increased Inequality:** Market failures can exacerbate income inequality, while state failures can lead to unequal access to opportunities and resources.
3. **Social Instability:** Economic hardship caused by market and state failures can lead to social unrest and conflict.

4. **Poverty and Inequality:** Market failures can lead to a lack of access to essential goods and services, while state failures can lead to a lack of social safety nets and opportunities.

TRADE POLICY IN DEVELOPMENT

Trade policy plays a crucial role in development, influencing economic growth, poverty reduction, and overall welfare, and it can be implemented through various instruments like tariffs, quotas, and trade agreements.

Definition:

Trade policy encompasses the rules, regulations, and standards that govern international trade, including imports and exports.

Scope:

It covers a wide range of issues, such as tariffs, quotas, subsidies, export promotion, and trade agreements.

Purpose:

Trade policy aims to manage international trade flows, promote economic growth, and address trade-related challenges faced by developing countries.

Trade Policy and Development

Economic Growth:

1. **Increased Trade:** Trade liberalization and integration into the global economy can lead to increased economic growth by allowing countries to specialize in producing goods and services where they have a comparative advantage.
2. **Access to Markets:** Trade policies can help developing countries gain access to larger markets, boosting exports and attracting foreign investment.
3. **Technological Transfer:** Trade can facilitate the transfer of technology and knowledge, which can contribute to productivity gains and economic development.

Poverty Reduction:

a. **Increased Income:** Trade can create jobs and generate income, particularly in export-oriented sectors, which can help lift people out of poverty.

b. **Access to Goods:** Trade can lower prices for essential goods and services, benefiting low-income households.

Other Development Goals:

a. **Diversification:** Trade policies can encourage diversification of export sectors, reducing dependence on a few commodities and making economies more resilient to shocks.

b. **Infrastructure Development:** Trade can create incentives for developing countries to invest in infrastructure, which is essential for economic development.

c. **Regional Integration:** Regional trade agreements can foster economic cooperation and integration, leading to increased trade and investment.

Instruments of Trade Policy

- **Tariffs:** Taxes on imported goods, which can protect domestic industries but also raise prices for consumers.
- **Quotas:** Limits on the quantity of goods that can be imported, used to restrict imports and protect domestic producers.
- **Subsidies:** Government payments to domestic producers, which can help them compete in international markets.
- **Trade Agreements:** Formal agreements between countries that establish rules for trade, including tariffs, quotas, and other trade barriers.

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Challenges in Trade Policy for Development

1. **Trade Imbalances:** Developing countries may face trade imbalances, such as a reliance on exporting primary commodities and importing manufactured goods, which can lead to dependence on external markets.
2. **Protectionism:** Developed countries may impose trade barriers that hinder access to their markets for developing countries.
3. **Unequal Bargaining Power:** Developing countries may have limited bargaining power in trade negotiations, which can lead to unfavorable outcomes.
4. **Capacity Constraints:** Developing countries may lack the capacity to implement and enforce trade policies effectively.

Key Considerations for Trade Policy in Developing Countries

1. **Trade Liberalization:** While trade liberalization can be beneficial, it's important to manage the process carefully to avoid negative impacts on domestic industries and vulnerable populations.
2. **Trade Diversification:** Developing countries should strive to diversify their export sectors and reduce their dependence on a few commodities.
3. **Trade Facilitation:** Simplifying trade procedures and reducing trade costs can help developing countries increase their competitiveness.
4. **Regional Integration:** Regional trade agreements can foster economic cooperation and integration, leading to increased trade and investment.
5. **Capacity Building:** Developing countries need to invest in building their capacity to formulate and implement effective trade policies.
6. **Social Safety Nets:** Trade liberalization can have negative impacts on vulnerable populations, so it's important to have social safety nets in place to cushion the impact.

IMPORT SUBSTITUTION

Import substitution (IS) is a trade policy that encourages domestic production by limiting the import of foreign goods. The goal is to change a country's economic structure by replacing foreign goods with domestic ones.

How it works

- The government imposes high tariffs on foreign goods
- This gives domestic manufacturers an advantage because their goods are cheaper and more popular than foreign products
- The policy creates gaps in the process of eliminating imports, which allows for investment in non-traditional sectors

History

- India adopted the import substitution model after independence and continued it until the 1991 reforms
- The policy was also used in many Latin American countries from the 1950s to the 1980s

Drawbacks

- While domestic producers captured the entire Indian market, there was slow progress in technological advancements
- The quality of Indian products was inferior to foreign manufactured ones
- By the mid-1960s, there was widespread disenchantment with the results of such policies.
- The import substitution policy was a tried and tested policy that ultimately failed.

EXPORT PROMOTION

Export promotion refers to government and industry initiatives that encourage and facilitate the export of goods and services from a country, often through various schemes, councils, and trade policies.

1. Export Promotion Councils (EPCs):

Purpose:

EPCs are organizations established by the government to promote the export of specific goods or services.

Examples:

- **Cashew Export Promotion Council of India (CEPC):** Promotes cashew exports.
- **Gem & Jewellery Export Promotion Council (GJEPC):** Focuses on promoting gems and jewelry exports.
- **Pharmaceuticals Export Promotion Council (PHARMEXCIL):** Supports pharmaceutical exports.
- **Carpet Export Promotion Council (CEPC):** Promotes handmade carpet exports.
- **Handloom Export Promotion Council:** Supports the export of handloom products.
- **Jute Products Development & Export Promotion Council (JPDEPC):** Facilitates jute product exports.
- **Powerloom Development & Export Promotion Council (PDEXCIL):** Promotes exports of powerloom products
- **Electronics and Computer Software Export Promotion Council (ESC):** Focuses on electronics and software exports.
- **Federation of Indian Export Organizations (FIEO):** Represents Indian exporters and promotes worldwide trade.
- **Indian Oilseeds & Produce Export Promotion Council (IOPEPC):** Promotes the export of oilseeds and related products.

2. Export Promotion Schemes:

1. **Export Promotion Capital Goods (EPCG) Scheme:** Allows exporters to import capital goods at reduced or zero customs duty, subject to fulfilling export obligations.

2. **Advance Authorisation Scheme:** Enables duty-free imports of goods required for exports.

3. **Export Subsidies:** Governments may provide financial incentives or tax breaks to encourage exports.

3. Key Functions of Export Promotion:

- **Market Access:** EPCs and schemes help exporters find and access new markets.
- **Trade Promotion:** Organizing trade fairs, buyer-seller meets, and participating in international exhibitions.
- **Industry Support:** Providing assistance to exporters through training, financing, and market research.
- **Policy Advocacy:** Working with the government to improve trade policies and conditions.
- **Promoting Competitiveness:** Helping Indian exporters become more competitive in the global market.

FISCAL POLICY FOR DEVELOPMENT

Fiscal policy, involving government spending and taxation, plays a crucial role in development by influencing macroeconomic stability, promoting economic growth, and reducing poverty through targeted investments and resource allocation.

1. Macroeconomic Stability and Growth:

- **Stimulating Demand:** During economic downturns, governments can use expansionary fiscal policy (increasing spending or lowering taxes) to boost aggregate demand and stimulate economic activity.
- **Controlling Inflation:** During periods of high inflation, contractionary fiscal policy (reducing spending or raising taxes) can help cool down the economy and stabilize prices.
- **Sustainable Growth:** Fiscal policy can be used to promote long-term, sustainable growth by investing in infrastructure, education, and other areas that enhance productivity and competitiveness.

2. Poverty Reduction and Social Development:

- **Targeted Spending:** Governments can use fiscal policy to allocate resources towards social programs that directly address poverty and inequality, such as healthcare, education, and social safety nets.
- **Public Goods and Services:** Investing in public goods and services, like infrastructure and sanitation, can improve living standards and create a more conducive environment for economic development.
- **Income Redistribution:** Tax policies can be used to redistribute income and wealth, ensuring that the benefits of economic growth are shared more equitably.

3. Resource Mobilization and Allocation:

- ✓ **Taxation:** Governments can mobilize resources through taxation to finance public spending and development initiatives.
- ✓ **Public Savings:** Fiscal policy can encourage public savings by reducing government spending and increasing surpluses in public sector enterprises.
- ✓ **Private Savings:** Fiscal measures, such as tax incentives, can encourage private savings and investment, which are crucial for long-term economic growth.
- ✓ **Borrowing:** Governments can also borrow from domestic and foreign sources to finance development projects.

4. Specific Examples of Fiscal Policy in Development:

- **Infrastructure Development:** Investing in roads, railways, ports, and energy infrastructure can improve connectivity, reduce transportation costs, and boost economic activity.
- **Education and Healthcare:** Investing in education and healthcare can improve human capital, leading to a more skilled and productive workforce.

- **Social Safety Nets:** Providing social safety nets, such as unemployment benefits and food assistance programs, can protect vulnerable populations during economic downturns and promote social stability.
- **Tax Reforms:** Implementing tax reforms, such as broadening the tax base and improving tax administration, can increase government revenue and ensure a more efficient and equitable tax system.

DIRECT TAX AND INDIRECT TAX:

Taxes are one of the biggest sources of income for the government. From your salary, meals at a restaurant, watching a movie at the multiplex, driving your car on roads, to simply purchasing a packet of biscuit from a general store, you pay many different types of taxes in many different ways. As a responsible citizen of the country, it is your duty to pay the taxes. But it is also equally important to know the different types of taxes implemented in the country. All the various taxations in India can be broadly classified into two categories- **direct and indirect tax**. Let us have a detailed look at the meaning of these two types of taxes.

DIRECT TAX

In simple words, a direct tax is a tax that you directly pay to the authority imposing the tax. For instance, income tax is imposed by the government, and you pay it directly to the government. These taxes cannot be transferred to any other entity or person. There are several acts which govern direct taxes. In India, CBDT (Central Board of Direct Taxes) which is governed by the Department of Revenue is responsible for the administration of direct taxes. The department is also involved in planning and providing inputs to the government regarding the implementation of direct taxes.

COMMON TYPES OF DIRECT TAXES IN INDIA

Some of the most common types of **direct tax** implemented in India are as follows-

1. Income Tax

The most common type of direct tax in India is income tax. It is imposed on the income you earn in a financial year based on the income tax slabs of the IT department. The tax is paid by individuals as well as businesses directly to the IT department. For individual taxpayers, there are also several tax deductions available under various sections of the IT Act.

2. Securities Transaction Tax

If you are involved in stock trading, each of your trade also has a small constituent known as the securities transaction tax. Irrespective of whether you made money on the trade or not, you will have to pay this tax. The broker collects this tax from you and passes on to the securities exchange, which then pays it to the government.

3. Capital Gains Tax

Every time you make capital gains, you will be required to pay capital gains tax. This capital gain could come from the sale of a property or from investments. Based on the capital gains and the duration for which you held the investment, you will be required to pay either LTCG (Long-Term Capital Gains) tax or STCG (Short-Term Capital Gains) tax.

BENEFITS OF DIRECT TAXES

There are some key benefits of direct taxes such as-

1. **Curbs Inflation-** In case if there is monetary inflation, the government can increase **direct tax** rates so that the goods and services demand can be reduced. As the demand falls, it helps in condensing inflation.
2. **Equitable-** Direct taxes are also known to be equitable as the progression principle is at its foundation. People with lower income pay lower taxes, and people with higher income pay higher taxes.
3. **Reduces Inequalities-**The higher taxes collected from the rich are used by the government to launch newer initiatives for the poor. The initiatives provide income sources to people with lower income, helping them improve their living standards.

DISADVANTAGES OF DIRECT TAXES

Direct taxes also have some drawbacks such as

1. **Considered a Burden-** As taxpayers are required to pay direct taxes like income tax in a single lump sum every year, they are considered a burden.

Moreover, even the documentation process is generally complex and time-consuming.

2. **Evasion is Possible-** While the government has made tax evasion very difficult now, there are still many fraudulent practices through which individuals and businesses can avoid or pay lower taxes than they should.
3. **Restrains Investments-**Due to the imposition of direct taxes like securities transaction tax and capital gains tax, a lot of people avoid investing. So, in a way, direct taxes restrain investments.

INDIRECT TAX

While direct taxes are imposed on income and profits, indirect taxes are levied on goods and services. A major **difference between direct and indirect tax** is the fact that while direct tax is directly paid to the government, there is generally an intermediary for collecting indirect taxes from the end-consumer. It is then the responsibility of the intermediary to pass on the received tax to the government. Unlike a direct tax, indirect taxes do not depend on the income of an individual. The tax rate is the same for everyone. The CBIC (Central Board of Indirect Taxes and Customs) is mostly responsible for handling indirect taxes in India. Just like CBDT, CBIC also works under the Department of Revenue.

COMMON TYPES OF INDIRECT TAXES IN INDIA

Some of the most important types of **indirect tax** in India are as follows-

1. Goods and Services Tax (GST) GST subsumed as many as 17 different indirect taxes in India like Service Tax, Central Excise, State VAT, and more. It is a single, comprehensive, indirect tax which is imposed on all the goods and services as per the tax slabs laid by the GST council. One of the biggest benefits of GST is that it mostly eliminated the cascading or tax-on-tax effect of the previous tax regime.

2. Customs Duty When you purchase something that needs to be imported from a foreign country, you are required to pay customs duty on it. Irrespective of whether the product has come to India by air, land, or sea, you will have to pay the customs duty on it. The goal of imposing this indirect tax is to make sure that every product entering India is taxed.

3. Value Added Tax (VAT) A VAT is a type of consumption tax imposed on products whenever its value increases throughout the supply chain. It is imposed by the state government, which also decides the VAT percentage on different goods. While GST has mostly eliminated VAT, it is still imposed on some products such as items that contain alcohol.

BENEFITS OF INDIRECT TAX

Some significant benefits of indirect taxes are listed below-

Poor Contributes Too-

It is essential for the country that every individual contributes towards its development.As the poor are often exempt from paying direct taxes, the indirect taxes ensure that even poor contribute towards nation-building.

Convenience-

Unlike direct taxes which are generally paid in a lump-sum, indirect taxes like GST are paid in small amounts. When you purchase a product or service, a small amount of GST is already included in the price, and this makes its payment more convenient for the taxpayers.

The collection is Easy-

If you want to know **what is the difference between direct and indirect tax**, one of the biggest of them is how they are paid. Unlike direct taxes, there are no documents or complex procedures involved in paying indirect taxes. You are required to pay the tax right when you purchase a product or service.

DISADVANTAGES OF INDIRECT TAXES

Regressive- Indirect taxes are widely known to be regressive in nature. While they make sure that everyone pays taxes irrespective of their income, they are not equitable. People from every income group are required to pay indirect taxes at the same rate.

Makes Products and Services More Expensive- As **indirect tax** is added to the price of goods and services, it makes them more expensive. For instance, products like cigarettes, high-end bikes, premium cars, etc. are included in the 28% tax slab of GST.

Lacks Civic-Consciousness- As indirect tax is added to the price of the product or service, the consumers are generally unaware of the tax they are paying. This is opposite to direct taxes where the taxpayer clearly knows the taxes he/she is paying.

THE BIGGEST DIFFERENCES BETWEEN DIRECT AND INDIRECT TAX

Context	**Direct Tax**	**Indirect Tax**
1. Imposed on	Income and profits	All the goods and services
2. Who pays	Individuals and businesses	End-consumers
3. How much	Depends on income and profits	Same for everyone
4. Transferability	Not transferable	Transferable
5. Tax Evasion	Possible	Not possible
6. Nature	Progressive	Regressive
7. Collections	Complex	Convenient
8.Common examples	Income tax and securities transaction tax	GST, excise duty, and VAT

DIRECT TAX IN INDIA

Direct taxes are levied on the income of taxpayers. The Department of Revenue of the Indian Government is responsible for the collection of direct tax in India. It is the central authority in all tax-related regulations. The Department of Revenue collects direct tax in India through a statutory body called the Central Board of Direct Taxes (CBDT).

TYPE OF TAX IS GST, DIRECT OR INDIRECT

Goods and Services Tax is a tax collected on the consumption of goods or services therefore, it is an indirect tax. It is divided into two parts, one that is distributed equally between the centre and the state in the form of the Central GST (CGST) and State GST (SGST). The other part is Integrated GST (IGST) taken by the central government for inter-state transactions.

THE DIFFERENCE BETWEEN GST AND INCOME TAX

GST	Income Tax
It is a form of indirect tax.	It is a form of direct tax.
It is levied on the consumption of goods and services for personal or business use.	It is levied on the income or profit of a taxpayer in a financial year.
It can be charged by registered entities only. Registration is required upon crossing a threshold of Rs. 20 lakhs as annual turnover, barring some exceptions.	Different rules apply to different types of taxpayers. Slab rates for individuals and HUFs and a flat rate for companies.
It is indirectly paid to the government.	The taxpayers pay this directly to the government.
It can be transferred from one person to the other through different stages of the supply chain.	It cannot be transferred to anyone else.
It has a broad scope since every member of a supply chain is subjected to tax.	It has a narrower scope since only one taxpayer is charged.
Different rates of GST apply based on the type of products and services.	Slab rates or flat rate applies based on the taxpayer and is often revised as part of the Finance Budget.
Quarterly returns and payments are made along with an annual return.	Advance tax is paid quarterly in some cases, and only annual returns are filed.
GST Audits might be needed for large entities.	An audit of the financial statements might be needed for larger entities.

THE LARGEST TAX IN INDIA

The largest source of tax in India is GST which is an indirect tax. Collections from GST in FY 22 crossed Rs. 6.75 lakh crores accounting for 26.8% of the central government's gross tax revenue in the year. The next largest tax in India is the corporate tax which is the direct tax levied on companies. It accounted for 25.2% of the total tax revenue in FY 22. Larger corporates are subjected to mandatory audits upon crossing a threshold, and the resultant tax is paid to the government.

PATTERN AND LEVEL OF TAXATION FINACIAL SYSTEM IN DEVELOPMENT

In developing countries, taxation patterns often involve a higher reliance on trade and consumption taxes, while developed countries tend to collect more revenue through income taxes. Financial systems play a crucial role in economic development by facilitating capital accumulation and efficient resource allocation.

Taxation in Developing Countries:

A. **Reliance on Trade and Consumption Taxes:** Developing countries often rely more on taxes on trade (import/export duties) and consumption (sales taxes) compared to developed nations, which tend to rely more on income taxes.

B. **Challenges in Tax Collection:** Developing countries may face challenges in tax collection due to weaker institutions, lower compliance rates, and less efficient tax administration.

C. **Evolution of Tax Structures:** As economies develop, tax structures evolve, with a shift towards direct taxes (like income tax) and a broader tax base.

D. **Trade Taxes as a Source of Revenue:** In the early stages of economic development, trade taxes can be a convenient and effective source of revenue due to the ease of identifying and accessing the tax base.

E. **Tax Policy and Economic Growth:** Tax policies can influence various aspects of economic progress, including investment, labor force expansion, and productivity growth.

F. **Importance of Financial Sector Development:** A well-developed financial sector is essential for economic growth, as it facilitates capital accumulation, mobilizes savings, and promotes efficient allocation of resources.

Taxation and Financial Systems in Development:

1. **Financial Intermediation:** A key role of the financial system is to act as an intermediary between savers and investors, channeling funds to productive activities.
2. **Mobilizing Savings:** An efficient financial system can mobilize and pool savings, which are crucial for investment and economic growth.
3. **Optimizing Capital Allocation:** A well-functioning financial system helps in optimizing the allocation of capital to the most productive sectors of the economy.
4. **Role of Financial Institutions:** Financial institutions, such as banks and insurance companies, play a vital role in facilitating financial transactions and promoting financial stability.
5. **Financial Markets:** Well-developed financial markets, including stock and bond markets, are important for attracting investment and promoting economic growth.
6. **Taxation of Financial Income:** The tax treatment of financial income (interest, dividends) can be complex, and developing countries need to carefully consider the implications for both tax revenue and economic activity.

THE ROLE OF FINANCIAL SYSTEM IN DEVELOPMENT

A well-functioning financial system is crucial for economic development, facilitating capital allocation, mobilizing savings, and enabling investment in productive activities, ultimately driving growth and stability.

1. Mobilizing Savings and Facilitating Investment:

a) **Linking Savers and Investors:** The financial system acts as a bridge, connecting individuals and businesses with savings to those who need funds for investment.

b) **Providing Investment Options:** It offers various financial instruments (stocks, bonds, loans, etc.) that allow individuals and businesses to invest their savings and raise capital.

c) **Promoting Capital Formation:** By channeling savings into productive investments, the financial system contributes to capital accumulation, which is essential for economic growth.

2. Efficient Capital Allocation:

a) **Identifying Profitable Projects:** A well-functioning financial system helps identify and allocate capital to projects with the highest potential for returns and economic impact.

b) **Reducing Information Asymmetry:** Financial institutions and markets provide information about investment opportunities, helping investors make informed decisions.

c) **Facilitating Risk Management:** Financial instruments and institutions help manage and diversify risks, encouraging investment in potentially risky but high-growth sectors.

3. Promoting Financial Stability and Economic Growth:

A. **Ensuring Liquidity:** The financial system provides liquidity, allowing individuals and businesses to access funds when needed.

B. **Facilitating Payments:** It enables efficient and secure payment systems, which are essential for economic transactions.

C. **Supporting Entrepreneurship:** Access to finance is crucial for entrepreneurs to start and grow businesses, creating jobs and stimulating economic activity.

D. **Promoting Financial Inclusion:** A developed financial system can broaden access to financial services, including credit and savings, for all segments of society, including the poor and vulnerable.

E. **Facilitating Trade and Investment:** A well-developed financial system supports international trade and investment, which are important drivers of economic growth.

THE ROLE OF CENTRAL BANKS

Central banks play a crucial role in maintaining a stable and healthy economy, primarily by implementing monetary policy, supervising the banking system, and acting as a lender of last resort, all while ensuring financial stability and managing the country's currency.

1. Monetary Policy:

a) **Setting Interest Rates:** Central banks set the short-term interest rate, which influences the overall cost of borrowing in the economy, impacting investment, consumption, and economic growth.

b) **Controlling the Money Supply:** They manage the amount of money circulating in the economy through various tools, such as open market operations (buying and selling government securities), reserve requirements for banks, and lending to banks.

c) **Maintaining Price Stability:** Central banks aim to keep inflation at a stable and healthy level, often using monetary policy to achieve this goal.

2. Banking Supervision and Regulation:

a) **Ensuring Financial Stability:** Central banks oversee and regulate the banking system to prevent financial crises and ensure the safety and soundness of banks.

b) **Lender of Last Resort:** They act as a lender of last resort to banks during times of financial distress, providing liquidity to prevent bank failures and systemic risks.

c) **Supervising Banks:** They monitor bank operations, capital adequacy, and compliance with regulations to maintain a stable and trustworthy financial system.

3. Other Important Functions:

a) **Banker to the Government:** Central banks manage the government's accounts, handle treasury operations, and provide financial advice to the government.

b) **Currency Issuance:** They are responsible for issuing and managing the country's currency, ensuring its stability and integrity.

c) **Payment System Oversight:** Central banks oversee the payment system, ensuring its efficiency, safety, and integrity.

d) **Economic Growth:** By implementing sound monetary policies, central banks contribute to sustainable economic growth and stability.

FINANCIAL LIBERALIZATION

Financial liberalization refers to the process of reducing government control over the financial sector, including interest rates, credit policies, and international capital flows, aiming to enhance efficiency and promote market-driven outcomes.

Definition:

Financial liberalization involves dismantling or reducing regulatory controls over the financial sector, allowing greater freedom for financial institutions and individuals to operate.

Objectives:

The goals of financial liberalization often include:

1. **Increased Efficiency:** Relying more on market forces to allocate capital and resources more efficiently.
2. **Improved Monetary Policy Effectiveness:** Making it easier for central banks to manage the economy through monetary policy tools.
3. **Enhanced Competition and Innovation:** Encouraging competition and innovation within the financial sector.
4. **Deepening of Financial Markets:** Promoting the growth and development of financial markets.

Measures:

Financial liberalization typically involves:

1. **Interest Rate Liberalization:** Removing or reducing controls on interest rates, allowing them to be determined by market forces.
2. **Relaxing Credit Controls:** Reducing restrictions on lending and credit availability.
3. **Liberalizing Capital Flows:** Allowing greater freedom for capital to move in and out of a country.
4. **Privatization:** Transferring state-owned financial institutions to private ownership.

Potential Benefits:

1. **Increased Savings and Investment:** Liberalization can lead to greater savings and investment as individuals and businesses respond to market signals.
2. **Economic Growth:** Financial liberalization can contribute to economic growth by improving the allocation of capital and fostering innovation.
3. **Improved Financial Sector Performance:** Greater efficiency and competition can lead to a stronger and more stable financial sector.

Potential Risks:

1. **Financial Instability:** Rapid liberalization can lead to financial instability, such as banking crises or currency fluctuations.
2. **Increased Vulnerability to External Shocks:** Liberalized economies can become more vulnerable to external shocks, such as changes in global interest rates or commodity prices.
3. **Inequality:** Financial liberalization can exacerbate income inequality if not managed carefully.

Examples:

- **Singapore:** Largely liberalized its financial sector and abolished capital controls in the mid-1970s.
- **India:** Undertook significant financial liberalization reforms in the early 1990s.