ECONOMICS OF DEVELOPMENT AND PLANNING

LEARNING MATERIAL

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Difference between Growth and Development

Economic development refers to the problems of underdeveloped countries and economic growth to those of developed countries. In fact, the terms, ‘development and growth’ have nothing to do with the type of economy. The distinction between the two relates to the nature and causes of change. Schumpeter makes the distinction clearer when he defines development as a discontinuous and spontaneous change in the stationary state which forever alters and displaces the equilibrium state previously existing; while growth is a gradual and steady change in the long run which comes about by a gradual increase in the rate of savings and population.

Human Development Index

Since 1990, the UNDP has been presenting the measurement of human development in terms of a Human Development Index (HDI) in its annual Human Development Report. The HDI is a composite index of three social indicators: life expectancy, adult literacy and years of schooling. It also takes into account real GDP per capita. Thus, the HDI is a composite index of achievements in three fundamental dimensions: a long and healthy life, knowledge and a decent standard of living.

The Classical Theory of Economic Development

The classical theory of economic development may be stated thus: suppose an expected increase in investment which adds to the existing stock of capital and to the steady flow of improved techniques. This increase in capital accumulation raises the wages fund. As a result wages rise. Higher wages induce an accelerated population growth which causes the demand for food to rise. Food production is raised by employing additional labour and capital. But diminishing returns to land bring about a rise in labour cost. Consequently, the price of corn goes up and in turn rents increase, wages rise, thereby reducing profits. Reduction in profits implies reduction in investment, retarded technological progress, diminution of wages fund and slowing down of population growth and capital accumulation.

Criticisms of the Stages of Economic Growth

The Stages of Economic Growth is the most widely circulated and highly commented piece of economic literature in recent years. Economists are one in doubting the authenticity of the division of economic history into five 'stages of growth' as presented by Rostow. Are these 'stages' inevitable like birth and death or do they follow a set 'sequence' like childhood, adolescence, maturity and old age? To maintain that every economy follows the same course of development with a common past and the same future is to over schematize the complex forces of development and to give the sequence of stages a generality that is unwarranted. The followings are the major criticisms of the stages of economic growth.

- Traditional society not essential for development
- Preconditions may not precede the take-off
- Overlapping in the stages
- Criticism of the take-off
- The stage of drive to maturity puzzling and misleading
- The stage of high mass consumption not chronological.

Assumptions of the Harrod and Domar Model

The Harrod-DOmar models of economic growth are based on the experiences of advances economists. Harrod and Domar assign a key role to investment in the process of economic growth. But they lay emphasis on the dual character of investment. The models constructed by Harrod and Domar are based on the following assumptions.

- ✓ There is an initial full employment equilibrium level of income
- ✓ There is the absence of government interference
- ✓ These models operate in a closed economy which has no foreign trade
- ✓ There are no lags in adjustments between investment and creation of productive capacity
- ✓ The average propensity to save is equal to the marginal propensity to save
- ✓ The marginal propensity to save remains constant
- ✓ The capital coefficient, i.e., the ratio of capital stock to income is assumed to be fixed
- ✓ There is no depreciation of capital goods which are assumed to possess infinite life
- ✓ Saving and investment relate to the income of the same year
- ✓ The general price level is constant
- ✓ There are no changes in interest rates
- ✓ There is a fixed proportion of capital and labour in the productive process
- ✓ Fixed and circulating capitals are lumped together under capital

The Joan Robinson's model of Economic Growth

Mrs. Joan Robinson in her book "The Accumulation of Capital" builds a simple model of economic growth based on the 'capitalist rules of the game'. But "it is not so much concerned with an automatic convergence to a moving equilibrium in a capitalist economy, as with studying the properties of equilibrium growth." Mrs. Joan Robinson's model is an elaboration of Harrod's growth model. The possible growth rate is Harrod's natural growth rate. In the golden age, the actual (G) and the natural growth (Gn) rates are equal to each other and the warranted growth rate (Gw) confirms to them. Both postulate neutral technical conditions and a constant saving ratio. However, Joan Robinson's theory of capital accumulation depends on the profit-wage relation and on labour productivity. Harrod's theory on the contrary depends on saving-income ratio and on capital productivity. The former stresses the importance of labour in capital accumulation while the latter that of capital.

"Joan Robinson's discussion of capital growth has the subtle effect of discrediting the whole idea of leaving so important a problem as economic growth to the capitalist rules of the game, for her model of laissez-faire growth demonstrates how precarious and insecure it is to entrust to private profit-makers the paramount task of achieving the stable growth of an economy consistent with the needs of a growing population and the possibility of advancing technology."

Centralized and Decentralized Planning

Planning may be centralized or decentralized. This division is made from the viewpoint of the execution of plans. Under centralized planning, the entire planning process in a country is under a central planning authority. This authority formulates a central plan, fixes objectives, targets and priorities for every sector of the economy. It takes all investment decisions in accordance with the goals and targets of the plan.

On the other hand, decentralized planning refers to the execution of the plan from the grass roots. Under it, a plan is formulated by the central planning authority in consultation with the different administrative units of the country. The central plan incorporates plans under the central schemes, and plans for the states under a federal set-up. Under decentralized planning, prices of goods and services are primarily determined by the market mechanism despite government control and regulation in certain fields of economic activity. Decentralized planning is superior to centralized planning in that it provides economic freedom and flexibility to the economy, but its dependence on the market mechanism leads to shortages or surpluses in the production of goods and services.

Use of Input – Output Technique in Planning

Input-output is a novel technique invented by Professor Wassily W. Leontief in 1951. It is used to analyze inter-industry relationship in order to understand the inter-dependencies and complexities of the economy and thus the conditions for maintaining equilibrium between supply and demand. It is also known as "inter-industry analysis".

A United Nations study lists the following uses of input-output models in development programming:

- ❖ They provide for individual branches of the economy's estimates of production and import levels that are consistent with each other and with the estimates of final demand
- ❖ The solution to the model aids in the allocation of the investment required to achieve the production levels in the programme and it provides a more accurate test of the adequacy of available investment resources
- ❖ The requirement for skilled labour can be evaluated in the same way
- ❖ The analysis of import requirements and substitution possibilities is facilitated by the knowledge of the use of domestic and imported materials in different branches of the economy
- ❖ In addition to direct rewquirements of capital, labour and imports, the indirect requirements in other sectors of the economy can also be estimated
- ❖ Regional input-output models can also be constructed for planning purposes to explore the implications of development programmes for the particular region concerned, as well as for the economy as a whole.

Disinvestment and its Importance in Economic Development

At the very best level, disinvestment can be explained follows: "Investment refers to the conversion of money or cash into securities, debentures, bonds or any other claims on money. As follows, disinvestment involves the conversion of money claims or securities into money or cash". Disinvestment can also be defined as the action of an organization (or government) selling or liquidating an asset or subsidiary. It is also referred to as 'disinvestment' or 'divestiture'. In most contexts, disinvestments typically refer to sale from the government, partly or fully, of a government – owned enterprise. A company or a government organization will typically disinvest an asset either as a strategic move for the company, or for raising resources to meet general / specific needs.

Presently, the Government has about Rs. 2 lakh crore locked up in PSUs. Disinvestment of the Government stake is, thus, far too significant. The importance of disinvestment lies in utilizing of funds for:

- ✓ To reduce the financial burden on the Government
- ✓ To improve public finances
- ✓ To introduce, competition and market discipline
- ✓ To fund growth
- ✓ To encourage wider share of ownership
- ✓ To depoliticize non-essential services.

Self-Sufficiency and Self-Reliance

Self – Sufficiency means a country is possessing (or producing) all the resources it needs. Self – Reliance is depending on own resources of the country avoiding dependence on external flows. Self-sufficiency entails the self being enough (to fulfill needs), and a self-sustaining entity can maintain self – sufficiency indefinitely. On a national scale, a totally self-sufficient economy that requires little or no trade with the outside world is called autarky. Self sufficiency is a way of thinking and living in which the goal is complete autonomy in at least one aspect of life. Self reliance is a way of thinking and living in which the family produces as much food, energy, shelter, clothing, and tools as it can for its own use, but it works in a complementary way with other families.

Economic Factors Influencing Economic Development

Economists regard factors of production as the main economic forces that determine growth. The growth rate of the economy rises or falls as a consequence of changes in them. Some of the economic factors are discussed below:

- Natural resources
- Capital accumulation
- Organization
- Technological progress
- Division of labour and scale of production
- Structural changes

Need for Non-Economic Indicators of Development

Non – economic factors influence economic growth along with economic factors. Economic development has much to do with human endowments, social attitude, political conditions and historical accidents. Therefore, social, cultural, psychological, human, political and administrative factors are as much important as economic factors in economic development. Development is not just a matter of having plenty of money nor is it purely an economic phenomenon. It embraces all aspects of social behavior; the establishment of law and order, scrupulousness in business dealings, including dealings with the revenue authorities, relationships between the family, literacy, familiarity with mechanical gadgets and so on. The following are essential non-economic factors:

- Social factors
- Human factor
- Political and Administrative factors

Rostow's Stages of Economic Growth

Rostow's the stages of economic growth are the most widely circulated and highly commented piece of economic literature in recent years. Professor W.W. Rostow has sought an historical approach to the process of economic development. He distinguishes five stages of economic growth. They are:

- The traditional society

  A traditional society has been defined as one whose structure is developed within limited production functions based on pre-Newtonian science and technology and as pre-Newtonian attitudes towards the physical world.

- The pre-conditions for take-off

  The second stage is a transitional era in which the pre-conditions for sustained growth are created. The pre-conditions for take-off were encouraged or initiated by four forces: the new learning or Renaissance, the new monarchy, the new world and the new religion or the reformation.

- The take-off

  The take-off is the 'great watershed' in the life of a society "when growth becomes normal condition…. Forces of modernization contend against the habits and institutions. The value and interests of the traditional society make a decisive breakthrough; and compound interest gets built into the society's structure". The take-off period is supposed to be short, lasting for about two decades.

- The drive to maturity

  Rostow defines it as the period when a society has effectively applied the range of modern technology to the bulk of its resources. It is a period of long sustained economic growth extending well over four decades. New production techniques take the place of the old ones.

- The age of high mass-consumption

  The age of high mass-consumption has been characterized by the migration to suburbia, the extensive use of the automobile, the durable consumers' goods and household gadgets. In this stage, the balance of attention of the society is shifted from supply to demand, from problems of production to problems of consumption and of welfare in the widest sense.

Doctrines of Unbalanced Growth

The theory of unbalanced growth is the opposite of the doctrine of balanced growth. According to this concept, investment should be made in selected sectors rather than simultaneously in all sectors of the economy. No underdeveloped country possesses capital and other resources in such quantities as to invest simultaneously in all sectors. Therefore, investment should be made in a few selected sectors or industries for their rapid development, and the economies accruing from them can be utilized for the development of other sectors. Thus the economy gradually moves from the path of unbalanced growth to that of balanced growth.

The doctrine of unbalanced growth, as propounded by Hirschman, is a heroic attempt at pointing out the way to accelerate economic development for underdeveloped countries. It is realistic and takes into account almost all aspects of development planning. The doctrine of unbalanced growth is, however, not free from certain limitations. They are:

- Inadequate attention to the composition, direction and timing of unbalanced growth
- Neglects resistances
- Beyond the capabilities of underdeveloped countries
- Lack of basic facilities
- Lack of factor mobility
- Emergence of inflationary pressures
- Linkage effects not based on data
- Too much emphasis on investment decisions.

Despite the weakness, the technique of unbalanced growth has come to be recognized as a novel technique for the development of underdeveloped countries. Russia was the first country to adopt it and has been successful in accelerating its rate of economic growth within a short-period of time.

Mahalanobis Two Sector Model

In October 1952, Mahalanobis developed a single – sector model based on the variables of national income and investment. It was further developed into a two sector model in 1953 where the entire net output of the economy was supposed to be produced in only two sectors – the investment goods sector and the consumer goods sector. Next he developed the famous four – sector model in 1955.

It was Mahalanobis's two-sector model which became the basis for his formulation of the four-sector model for th second five year plan. The Mahalanobis two-sector model was based on the following assumptions:

- ✓ It is related to a closed economy where there is no foreign trade
- ✓ The economy consists of two sectors: the consumer goods and the capital goods sector

- ✓ There is total non-shiftability of capital equipment once installed in any of the sectors.
- ✓ There is full capacity production in the consumer goods sector as well as in the capital goods sector
- ✓ Investment is determined by the supply of capital goods
- ✓ There are no changes in process.

A higher rate of investment on capital goods in the short-run would make available a smaller volume of output form consumption, but in the long-run, it would lead to a higher growth rate of consumption.

Difference between the Harrod and Domar Model with their Limitations

The Harrod-Domar models of economic growth are based on the experiences of advances economists. Harrod and Domar assign a key role to investment in the process of economic growth. But they lay emphasis on the dual character of investment. Both Harrod and Domar are interested in discovering the rate of income growth necessary for a smooth and uninterrupted working of the economy. Though their models differ in details, yet they arrive at similar conclusions. The followings are the major difference between the two models:

- ❖ Domar assigns a key role to investment in the process of growth and emphasizes on its dual character but Harrod regards the level of income as the most important factor in the growth process
- ❖ The Domar model is based on one growth rate but Harrod uses three distinct rates of growth: the actual rate, the warranted rate and the natural rate
- ❖ Domar uses the reciprocal of marginal capital – output ratio, while Harrod uses the marginal capital – output ratio
- ❖ Domar gives expression to the multiplier but Harrod uses the accelerator about which Domar appears to say nothing
- ❖ The formal identity of Harrod's Gw equation and DOmar's equation is maintained by Domar's Assumption
- ❖ For Harrod the business cycle is an integral part of the path of growth and for DOmar it is not so
- ❖ While Domar demonstrates the technological relationship between capital accumulation and subsequent full capacity growth in output, Harrod shows in addition a behavioural relationship between rise in demand and hence in current output on the one hand, and capital accumulation on the other.

Steps for Plan Formulation and Requisite for Successful Planning

Planning is a technique, a means to an end being the realization of certain pre-determined and well-defined aims and objectives laid down by a central planning authority. The formulation and success of a plan require the following:

- ➢ Planning commission

- Statistical data
- Objectives
- Fixation of targets and priorities
- Mobilization of resources
- Balancing in the plan
- Incorrupt and efficient administration
- Proper development policy
- Economy in administration
- An education base
- A theory of consumption
- Public cooperation

Investment Criteria in Economic Development

The problem of investment criteria involves the principles underlying the allocation of scarce investment resources in a rational manner so as to maximize the national income in an underdeveloped economy. It is a commonly known fact that private enterprise in such economies is motivated by profit maximization. Very often private investment decisions are for projects that are not conductive to economic development. Economists have propounded a number of investment criteria which are discussed below:

- ✓ The capital – Turnover Criterion
- ✓ The Social Marginal Productivity Criterion
- ✓ The Reinvestment Criterion
- ✓ The Time Series Criterion

Role of Foreign Capital in Economic Development

Foreign capital can enter a country in the form of private capital and / or public capital. Private foreign capital may take the form of direct and indirect investments. Public foreign capital is more important for accelerating economic development than private foreign capital. The financial needs of LDCs are so great that private foreign investment can only partially solve the problem of financing. The followings are the major role played by foreign capital in economic development.

- Solution to the problem of capital deficiency
- Technical knowledge and specialized capital equipment
- To correct adverse balance of payments
- Foreign capital helps to maintain the production level
- Helpful in the development of economic and social overheads
- To break vicious circle of poverty
- Rapid rate of capital formation
- Proper use of natural resources and risky projects
- Helpful in combating inflation
- Tends to increase productivity, income and employment

Role of State in Economic Development

It is now universally recognized that in order to overcome the rigidities inherent in an LDC, the state must play a positive role, it cannot act as a passive spectator. The problems of LDCs are of such a magnitude that they cannot be left to the free working of the economic forces. Private enterprise is unable to solve them because it does not exist in the modern sense of the term. State action is, therefore, indispensable for the economic development of such countries.

The sphere of state action is, therefore, very vast and all pervading. It includes maintaining public services, influencing the use of resources, influencing the distribution of income, controlling the quantity of money, controlling fluctuations, ensuring full employment, and influencing the level of investment. The followings are the major role played by the state for economic development.

- Changes in institutional framework
- Organizational changes
- Social and economic overheads
- Agricultural development
- Industrial development
- Monetary and fiscal policies
- Increase in foreign trade

Physical Quality of Life Index

Morris D. Morris constructed a composite Physical Quality of Life Index (PQLI) in 1979 relating to 23 developed and developing countries for a comparative study. He combines three component indicators of infant mortality, life expectancy at age one and basic literacy at age 15 to measure performance in meeting the most basic needs of the people. This index represents a wide range of indicators such as health, education, drinking water, nutrition and sanitation.

Each indicator of the three components is placed on a scale of zero to 100 where zero represents an absolutely defined worst performance and 100 represents an absolutely defined best performance. The PQLI index is calculated by averaging the three indicators giving equal weight to each and the index is also scaled from 0 to 100.

Important Economic Indicators

Economic indicators are key statistics that indicate the direction of an economy. An economic indicator is a statistic about an economic activity. Economic indicators allow analysis of economic performance and predictions of future performance. One application of economic indicators is the study of business cycles. The followings are the five important economic indicators:

- Real GDP (Gross Domestic Product)

- M2 (Money Supply)
- Consumer Price Index (CPI)
- Producer Price Index (PPI)
- Consumer Confidence Survey
- Current Employment Statistics (CES)

Classical Theory of Economic Development

The classical theory of economic development may be stated thus: suppose an expected increase in profits brings about an increase in investment which adds to the existing stock of capital and to the steady flow of improved techniques. This increase in capital accumulation raises the wages fund. As a result wages rise. Higher wages induce an accelerated population growth which causes the demand for food to rise. Food production is raised by employing additional labour and capital. But diminishing returns to land bring about a rise in labour cost. This simple and abstract classical theory of development is not free from criticisms. They are:

- ✓ Ignores middle class
- ✓ Neglects public sector
- ✓ Less importance to technology
- ✓ Unrealistic laws
- ✓ Wrong about wages and profits
- ✓ Unrealistic growth process

Limitations of Nurkse Theory

Ragner Nurkse developed the thesis that disguised unemployment in overpopulated underdeveloped countries can be a source of capital formation. According to Nurkse, the state of disguised unemployment in underdeveloped countries constitutes a disguised saving potential. Nurkse has split up the problem of mobilizing the disguised unemployed as a saving potential in two parts: firstly, how to feed the surplus population transferred to the various capital projects and secondly, how to provide tools to the workers to work with.the concept of disguised unemployment as a concealed saving potential has led to considerable controversy. The followings are the major limitations of the theory.

- Propensity to consume not constant
- Problems of collection and distribution of food surplus
- Marketable surplus does not increase
- Difficulty to mobilize disguised unemployed
- Not possible to get work without payment of wages
- Successful only in totalitarian states
- Problems of inflation and balance of payments
- Unskilled labour fails to increase the output of fixed capital
- Unrealistic assumption of technological neutrality
- Effects of increasing population on capital formation

- ❖ Not applicable to directly productive activities
- ❖ Fall in production
- ❖ Defective empirical evidence

Requirements for Steady Growth

The concept of steady state growth is the counterpart of long-run equilibrium in static theory. It is consistent with the concept of equilibrium growth. In steady state growth all variables, such as output, population, capital stock, saving, investment, and technical progress, either grow at constant exponential rate, or are constant. The neo-classical theory of economic growth is concerned with analyzing the properties of steady state growth based on the following properties:

- ✓ There is only one composite commodity which can be consumed or used as an input in production or can be accumulated as a capital stock
- ✓ Labour force grows at a constant proportional rate
- ✓ Full employment prevails at all times
- ✓ Capital-output ratio is also given
- ✓ Saving-income ratio is constant
- ✓ There are fixed coefficients of production
- ✓ There is no technical change

Meade's Neo-Classical Model of Economic Growth

Professor J.E. Meade has constructed a neo-classical model of economic growth which is designed to show the way in which the simplest form of economic system would behave during a process of equilibrium growth. The neo-classical model has been severely criticized due to its unrealistic assumptions. This model is steeped in the classical tradition of a perfectly competitive economy where all production units are assumed independent of each other. But these are unrealistic assumptions for neither is there perfect competition nor are the production units independent of each other. The assumption of the neo-classical theory that there are only constant returns to scale is also defective. The fact is that there are increasing returns to scale rather than constant returns in the growth process.

Another serious defect of the neo-classical model stems from the assumptions that all machines are alike and there is perfect malleability of machines. The latter implies that the ratio of labour to machinery can be changed both in the short and long run. But this is unrealistic because the ratio of labour to machinery cannot be changed in the short run. Thus Meade sidetracks the problem of foresight by assuming perfect malleability of machines and depreciation by evaporation. This makes his model impracticable. This model also completely neglects the role of institutional factors in the development process.

Financial Planning

Financial planning refers to the technique of planning in which resources are allocated in terms of money while physical planning pertains to the allocation of resources in terms of men, materials and machinery.

Finance is the main key to economic planning. If sufficient finances are available, it is not difficult to achieve physical targets. But without the stipulated financial resources it is not possible to carry the plan to its successful culmination. Financial planning is essential in order to remove maladjustments between supplies and demand and for calculating costs and benefits of the various projects.

Perspective Planning and Annual Planning

The phrase 'perspective planning' refers to long-term planning in which long range targets are set in advance for a period of 15,20 or 25 years. A perspective plan, according to Indian Planning Commission is a blueprint of developments to be undertaken over a longer period. The main purpose of a perspective plan is thus to provide a background to the shorter term plans, so that the problems that have to be solved over a very long period can be taken into account in planning over a shorter term. There is Perspective Planning Division in the Planning Commission of India which is entrusted with the task of perspective planning.

A five-year is further broken up into annual plans so that each annual plan fits into broad framework of the five-year plan. Plans of either kind are further divided into regional and sectional plans. Regional plans pertain to regions, districts and localities being further split up into sectional plans for agriculture, industry, foreign trade, transportation etc.

Foreign Capital in Economic Development

Foreign capital has a key role in the economic development process of the country. It is a source of modernization, income and employment generation in the economy. India's recent liberalization of its foreign investment regulations has generated strong interest by foreign investors, turning India into one of the fastest growing destinations for global investment inflows. Foreign firms are setting up joint ventures and wholly owned enterprises in services such as computer software, telecommunications, financial services, and tourism.

Foreign capital helps to augment domestic resources of the economy and enables it to achieve higher growth rates. It improves productive efficiency and technology up gradation in the host country but it can also lead to inappropriate investment and consumption pattern. However, the economic benefits from foreign capital don't accrue automatically. There is a need to develop a healthy enabling environment to reap the benefits.

b) Examine your understanding about flow of FDI after Globalization.

Foreign Direct Investment (FDI) is money invested in production by a foreign party rewarded with part-ownership of production. Of the three important aspects of liberalization – finance, trade and investment – financial liberalization has been the most pronounced. During this globalization era there has been progressive and extensive liberalization of controls on financial flows and markets leading to economic globalization. Economic globalization and financial liberalization centres on the movement of capital of which FDI was a major form.

However, the flow of FDI even among developing nations was not uniform. Much of this FDI has centred on only a few developing countries. Least developed countries in particular were receiving only very small FDI despite having liberalized their policies. There were some negative impacts of these private capital flows. There was a general and increasing concern about the fragility and systems and the vast amounts of financial flows.

Non-Economic Factors Influencing Economic Development

Non-economic factors influence economic growth along with economic factors. According to Nurkse, "Economic development has much to do with human endowments, social attitudes, political conditions and historical accidents". Therefore, social, cultural, psychological, human, political and administrative factors are as much important as economic factors in economic development. Development is not just a matter of having plenty of money nor is it purely an economic phenomenon. It embraces all aspects of social behavior; the establishment of law and order, scrupulousness in business dealings, including with the revenue authorities, relationships between the family, literacy, familiarity with mechanical gadgets and so on.

The followings are the major non-economic factors influencing economic development.

- ✓ Social factors
- ✓ Human factor
- ✓ Political and administrative factors

Characteristics of an Underdeveloped Economy

The term 'underdeveloped' has been used in a variety of ways. An underdeveloped country is one which has no potentialities of development. In order to examine the problems of an underdeveloped country, it is useful to have in mind a general sketch of the economy of such a country. Though it is difficult to locate a representative underdeveloped country on the world map, yet it is possible to focus attention on some of its characteristics. They are:

- ❖ General poverty
- ❖ Agriculture, the main occupation
- ❖ A Dualistic Economy
- ❖ Underdeveloped Natural Resources
- ❖ Demographic Features

- ❖ Unemployment and Disguised unemployment
- ❖ Economic Backwardness
- ❖ Lack of Enterprise and Initiative
- ❖ Insufficient Capital Equipment
- ❖ Technological Backwardness
- ❖ Foreign Trade Orientation

The Theory of Balanced Growth

The doctrine of balanced growth has several authors who interpret it in their own way. The doctrine of balanced growth has been advocated by Rosenstein-Rodan, Ragnar Nurkse and Arthur Lewis. Balanced growth, therefore, requires balance between different consumer goods industries, and between consumer goods and capital goods industries. Rosenstein-Rodan was the first economist who propounded the theory of balanced growth without using these words in his 1943 article. He argued that the whole of the industry to be created in eastern and south-eastern Europe should be treated and planned like one huge firm or trust. According to Nurkse, vicious circles of poverty are at work in underdeveloped countries which retard economic development. The doctrine of balanced growth has been severely criticized by Hirschman, Singer, Kurihara and others on the following grounds:

- ➢ Rise in costs
- ➢ No attention to reducing costs
- ➢ Other problems
- ➢ Fails as a theory of development
- ➢ Beyond the capabilities of underdeveloped countries
- ➢ Disproportionality in factors
- ➢ Shortage of resources
- ➢ Wrong assumption of increasing returns
- ➢ Capital lumpiness not essential for development
- ➢ Balanced growth not essential for induced investment
- ➢ Does not consider planning
- ➢ Concept of balanced growth applicable to developed countries
- ➢ Scarcities and bottlenecks encourage growth

The Marxian Theory and its Applicability on Underdeveloped Countries

The Marxian theory is not applicable directly to underdeveloped countries. Marx did not think of the problems of such countries. Marx was mainly concerned with problems connected with the development of capitalism in the Western world. Colonies were regarded as one of the "highest stages" in capitalist development. Foreign domination was regarded as the principal cause of economic backwardness of the colonies. The only obvious remedy was their political freedom.

As a matter of fact, it is Marx's Departmental Schema that is applicable to underdeveloped countries. Such a country is primarily a dualistic economy consisting of a capitalist sector and a subsistence agriculture and small scale sector which may be said to represent Marx's two departments. Rapid economic development is possible by reorganizing and expanding the capitalist sector (Department 1) and transforming the subsistence sector (Department 2) into the former so as to increase the economic surplus. The primary aim has been to create larger employment opportunities, to increase purchasing power and fresh demand, to build a strong capital base and increase productive and technical capacities within the economy.

Mahalanobis Four Sector Model

The Mahalanobis model is not a growth model in the real sense, rather it is an allocation model. Being associated with the Planning Commission, Mahalanobis knew that the maximum funds available for net investment during the Second Five Year Plan would be approximately Rs.5600 crores and the aim was to provide additional employment to 10-12 million people. He put all this data in a simple simultaneous equation system given below and obtained the solution which became the basis of India's Second Five Year Plan.

The Mahalanobis model takes a four-sector economy consisting of:

- ❖ The investment goods sector (k)
- ❖ The factory produced consumer goods sector (C_1)
- ❖ The small household produced consumer goods sector (C_2)
- ❖ Services producing sector (C_3)

The theory has the following limitations:

- ✓ Fails to solve any definite welfare function
- ✓ Arbitrary value
- ✓ Technique not applicable to open economy
- ✓ Supply of agricultural produce not infinity elastic
- ✓ Supply of labour also not infinitely elastic
- ✓ Production technique not constant
- ✓ Arbitrary values for structural parameters
- ✓ Silent over investment in a mixed economy
- ✓ Ignores factor prices
- ✓ Closed model
- ✓ Neglects demand functions
- ✓ Failure to link up investment decisions with the rates of saving required
- ✓ Failure to explain the problem of choice of techniques

Joan Robinson's Model of Capital Accumulation

Mrs Joan Robinson in her book “The Accumulation of Capital” builds a simple model of economic growth based on the ‘capitalist rules of the game’. But “it is not so much concerned with an automatic convergence to a moving equilibrium in a capitalist economy, as with studying the properties of equilibrium growth”.

Mrs. Joan Robinson’s model is an elaboration of Harrod’s growth model. The possible growth rate is Harrod’s natural growth rate. In the golden age, the actual (G) and natural growth (Gn) rates are equal to each other and the warranted growth rate (Gw) confirms to them. Both postulate neutral technical conditions and a constant saving ratio. However, Joan Robinson’s theory of capital accumulation depends on the profit-wage relation and on labour productivity. Harrod’s theory on the contrary depends on saving-income ratio and on capital productivity. The former stresses the importance of labour in capital accumulation while the latter that of capital.

Economic Planning is Essential for Underdeveloped Countries

One of the principal objectives of planning in underdeveloped countries is to increase the rate of economic development. To remove market imperfections, to mobilize and utilize efficiently the available resources, to determine the amount and composition of investment, and to overcome structural rigidities, the market mechanism is required to be perfected in underdeveloped countries through planning.

The need for planning in underdeveloped countries is further stressed by the necessity of removing widespread unemployment and disguised unemployment in such economies. The planning for development is indispensable for removing the poverty of nations.

Essentials of Planning by Direction and Planning by Inducement

Planning by direction is an integral part of a socialist society like that of the Soviet Union. It entails complete absence of laissez-faire. There is one central authority which plans, directs, and orders the execution of the plan in accordance with pre-determined targets and priorities. Such planning is comprehensive and encompasses the entire economy.

Planning by inducement is democratic planning. It means planning by manipulating the market. There is no compulsion by persuasion. There is freedom of enterprise, freedom of consumption and freedom of production. But these freedoms are subject to state control and regulation. People are induced to act in a certain way through various monetary and fiscal measures. If the planning authority wishes to encourage the production of a commodity, it can give subsidy to the firms.

The Role of Public Sector in Economic Development

Public sector plays an important role in accelerating the development of underdeveloped countries. In such economies the private sector is engaged in the production of a few consumer goods and in working plantations and mines. The public sector can be extended over a wide range of economic activities that tend to accelerate development. The followings are the major role played by the public sector in economic development:

- To provide public utilities
- To develop natural resources
- To help private enterprise
- To remove exploitation in trade
- Indirect benefits
- Source of capital formation

Importance of Foreign Capital on Economic Development

Foreign capital can enter a country in the form of private capital and / or public capital. Private foreign capital may take the form of direct and indirect investments. Public foreign capital is more important for accelerating economic development than private foreign capital. The financial needs of LDCs are so great that private foreign investment can only partially solve the problem of financing. The followings are the major importance of foreign capital in economic development.

- Solution to the problem of capital deficiency
- Technical knowledge and specialized capital equipment
- To correct adverse balance of payments
- Foreign capital helps to maintain the production level
- Helpful in the development of economic and social overheads
- To break vicious circle of poverty
- Rapid rate of capital formation
- Proper use of natural resources and risky projects
- Helpful in combating inflation
- Tends to increase productivity, income and employment