UNIT 2 DEVELOPMENT PARADIGMS*

Structure

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2.0 OBJECTIVES

After reading this unit, you will be able to:

- distinguish between the terms ‘growth’ and ‘development’;
- discuss the different approaches to development;
- distinguish between the two economic systems of capitalism and socialism;
- define the concept of ‘mixed economy’;
- analyse the two major phases of development paths pursued in India; and
- explain the trends in integration of the Indian economy with the global economy.

2.1 INTRODUCTION

Economic growth and economic development are fundamentally different. Economic growth generally refers to rise in the national income or per capita

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income. In addition to growth, economic development involves improvements in health, education and other aspects of human welfare and also major structural changes like industrialisation and urbanisation. Specific indicators (like HDI) or goals (MDG) are used for measuring development. Human Development Index (HDI) is a composite measure reflecting the goals of leading a long life, acquiring knowledge and material well-being. The millennium development goals (MDGs) rely on a multiplicity of goals and targets for advancing human well-being within a specified time.

2.2 APPROACHES TO DEVELOPMENT

Historically, there has been a number of schools/thoughts on the economic analysis of development [e.g. Adam Smith and Classical Political Economy (1776), Marxist Economics of Marx and Engels (1848), Neoclassical Economics of Jevons, Menger and Marshall (1890s), Keynesian macroeconomics (1930s), Neoclassical growth theory by Solow (1950s), Dependency theories (1960s), etc.]. The classical and neoclassical economists believed that the major cause of underdevelopment is shortage of factors of production like capital and labour and the lack of technological progress. Keynesian school recommended that the problems of underdevelopment can be solved by extension of government activities. Marx explained the problems of underdevelopment in terms of Asiatic mode of production and lack of class struggle. Neo-Marxists writers like Paul Baran and Andre Frank explained the problems of underdevelopment in terms of external factors like global capitalism and exploitation.

For achieving the goals of economic development, there are several approaches. They require specific institutional framework within which economic activities are carried out. Broadly, market and state are two such broad institutions which are expected to facilitate the economic activities.

2.2.1 Market Based Approach

This approach assumes that, under conditions of well developed perfectly competitive markets, resources are used optimally by minimising the costs and maximising profits. Price signals, including the profits, serve as incentive to investment for achieving faster growth. Ideally, therefore, perfectly functioning markets without any intervention are seen as a strategy for faster accumulation and growth. However, in the post-World War II era, when most of the former colonies became independent and embarked upon the process of development, these countries faced serious gaps in markets as these were underdeveloped in many of the economies. The absence of markets was particularly noticeable in the 'subsistence segments'. These segments were related to several areas of development of public goods for which there was no market but there was an immense public need. Many of these underdeveloped markets had to be developed by the state as an essential requirement for giving a push to the development process.

2.2.2 State Led Approach

In underdeveloped countries with the existence of: (i) subsistence agriculture, (ii) weak industrialisation, (iii) vast underemployment, low income, savings and investment, (iv) poor infrastructure, etc. there was a need for a big push in investment. The supporters for state intervention viewed that desired economic change in key sectors could be achieved through planned mobilisation and allocation of resources to the public sector. However, in many economies which

initially favoured this approach, public sector led growth strategy has since fallen out of policy favour on the grounds of generating red-tapism, corruption (rent seeking), inefficiency and losses. Based on these arguments, there has been a tendency towards reducing the role of the state to specific sectors of social importance and establishing the infrastructural base in the economy. There are still those who argue that state's role should not be minimal particularly in the areas of health, education and infrastructure thereby providing the right environment for entrepreneurial activity to thrive.

2.2.3 Inclusive Growth Approach

This approach views growth and equity as complements. In India, the term 'inclusive growth' appeared as an official development strategy in the Eleventh Five Year Plan (2007-12). However, the concept of 'growth with justice' or 'growth with equity' has been part of the planning strategy right from the beginning of the First Plan in India. The basic premise for 'growth with justice' (i.e. distributional justice) has been that in an economy with gross disparities in wealth and assets, growth of national income without intervention would result in perpetuation of inequalities. In other words, besides growth, as reduction in inequalities is one of the objectives of development, it is considered necessary that the growth strategy should involve appropriate institutional arrangements to ensure equitable distribution of the gains of growth. An institutional framework for growth with equitable distribution envisages a substantial role for state as much in the productive sectors as in the regulation of its distribution.

2.2.4 Sustainable Development Approach

The sustainable development argues that global focus on growth should be replaced by the goal of sustainable development to avoid the 'tragedy of commons', a situation in which common resources are overexploited since the individual actors lack the motivation to use them sustainably. Brundtland Commission Report (1987) stated that: *SD is that development which meets the needs of the present without compromising the ability of future generations to meet their own needs*. It, therefore, underlined the two key essentials as: (i) the need to protect the interests of the world's poor; and (ii) the limitations of technology and social organisations in preventing the exploitation of environmental resources (so as not to affect the needs of future generations) adversely should be duly accounted for. The Commission emphasised the overriding priority of attending to the needs of the poor within any society in particular and the world as a whole in general. The rationale for SD is, therefore, to raise the standard of living, especially the standard of living of the most disadvantaged segments in society, taking due care to avoid or minimise 'uncompensated' future costs. The Sustainable Development Goals (SDGs) cover 17 goals: (i) no poverty, (ii) zero hunger, (iii) good health and well-being, (iv) quality education, (v) gender equality, (vi) clean water and sanitation, (vii) affordable and clean energy, (viii) decent work and economic growth, (ix) industry, innovation and infrastructure, (x) reduced inequality, (xi) sustainable cities and communities, (xii) responsible consumption and production, (xiii) climate action, (xiv) life below water, (xv) life on land, (xvi) peace, justice and strong institutions and (xvii) partnerships to achieve the goals.

2.3 ECONOMIC SYSTEMS: CAPITALISM AND SOCIALISM

Capitalism is a societal structure in which the capitalist class thrive by virtue of their ownership and control of the society's means of production. It is thus an economic system based on private ownership of property and means of production in which free market that allows competition for exchanging goods and services operates. Thus, in principle, it is the individuals who decide on 'how, what and for whom to produce'. Under capitalism, individuals are thus encouraged to follow their own self interest while market forces of demand and supply are relied upon to coordinate the economic activity. Different countries have been endowed with different forms of capitalism (found in modern times) such as state-guided capitalism, big-firm capitalism and entrepreneurial capitalism. Socialism, on the other hand, is a system that emphasises the collective ownership of the means of production. It ascribes a large role to the State in the running of the economy with widespread public ownership of key industries. Although socialism allows limited scope to market forces, Marx regarded socialism as a transitional stage between 'end of a private enterprise system and the beginnings of communism'. In the process of its historical evolution, we find different forms of socialism: (i) socialism with the entire economy associated with a centrally planned economic system (as in earlier Soviet-type economies); (ii) market socialism i.e. economies with a modified type of central planning with a role for market mechanisms (e.g. Hungary and Yugoslavia) a kind of planned economy which attempts to improve allocation using markets; etc.

In theory, therefore, unlike capitalism, socialism is a system based on individual's goodwill to others rather than their own self-interest. However, in practice, socialism has become an economic system based on government ownership of the means of production with centralised planning. Since socialism is based on a system which originated in the former-Soviet union, it has often come to be referred as 'soviet-style socialism'. In the 1980s, a number of countries had Soviet-style socialism but in the late 1980s and early 1990s, many of these economies/countries were in turmoil and ultimately veered towards market oriented systems. The example of China shows another form of centralistic socialism, which accords priority to markets ensuring high growth rates but not social freedom. We can, therefore, conclude that within the two broad systems of capitalism and socialism, the paths to development pursued in terms of ISI or ELG varies depending on the domestic socio and economic compulsions of a country. As you must be aware by now, India was forced to adopt policies of economic reforms due to conditions of economic distress faced on account of critical BoP crisis in 1991. Nevertheless, we can say that the Indian stand, taken as early as in 1950s, to adopt the mixed economy path with social freedoms enshrined in the constitution of the country reflected wisdom in which the choice between ISI strategy made in the beginning and the shift to ELG strategy made later stands out as a model of balanced perspectives.

2.4 TWO PHASES OF DEVELOPMENT: MIXED ECONOMY

Mixed-economy combines the state and the market, in a mutually reinforcing framework, in its approach to development. It involves the co-existence of private sector enterprises alongside the public enterprise. It combines the salient features of capitalism and socialism. This means the capitalist enterprises with self-interest

and profit motive operate in a number of activities alongside many public sector production units. The latter operate both in production as well as social sectors but more in the sectors like primary education and primary healthcare with a larger societal interest. India is regarded as a good example of mixed economy which followed this model right from the time of its independence. While both the public and private sectors coexisted, a central role was assigned to the state's planning machinery for resource allocation across sectors. The stated primary objectives of the planning process were economic growth with social justice and self-reliance. The early Five-Year Plans of India provided the basic framework for the economic development with a mixed economy strategy. The apparent logic behind this policy was to place the commanding heights of the economy in the hands of the State, through state ownership of basic heavy industries and infrastructure sectors and to allow the private sector to operate where scale economies were not important. The basic idea behind the approach was that through a judicious mixture of plan stimulus and market efficiency, the objectives of both growth and equity could be promoted. In the agricultural sector, production decisions were by and large taken by private producers with government's role limited to infrastructure development by way of irrigation facilities, extension services and trade in some major commodities. In the manufacturing and service sectors, state played a commanding role by owning and operating many industries and by regulating private investment through the instrument of licensing.

Since the introduction of economic reforms in 1991, there has been a substantial expansion of economic space of private sector with its corresponding contraction for the public sector. Thus, the mixed-economy approach in India can be said to have moved from the state of commanding heights to the public sector in the initial four decades of its planning to a state where the majority space was accorded to the private sector and the market. Let us now take a somewhat detailed look at these two phases of the Indian economy in its transition.

2.4.1 Public Sector at Commanding Height (Phase I)

In any economic system state can play at least three major roles viz. (i) as a producer of goods and services, (ii) as a regulator of the overall system, and (iii) as a supplier of 'public goods' or 'social goods' like primary education and health. The first role as a producer of goods and services finds expression in the system of planning with public enterprises engaged in major productive activities, at least in the critical areas of the economy (e.g. power generation and distribution). The second role of 'regulator' conveys the authority wielded by the state in setting the rules of the game. In fact, the quality of the economic performance of markets depends critically on the quality of public intervention through regulation by way of a complementary role. The third role of state is that of a 'welfare provider' i.e. this role prompts the state to support private initiatives through the provision of required infrastructure and by efforts directed at human development so as to enhance the capability of the masses. This can therefore be regarded as the role of a 'facilitator' where the state intervenes in areas where the markets cannot perform effectively.

In the initial years of planning, as India was capital constrained, and given that the markets were not well formed, the system devised was a combination of involvement of the state in production in some industries and regulate the private sector in others. The role of regulation was carried out by the grant of licenses required for investment, production and imports. In particular, availability of foreign exchange, credit allocation and in some cases even prices (e.g. price of the essential commodities, agricultural commodities) were controlled by the

government. Also, the government reserved the right to enter even those industries which were not explicitly reserved for the public sector. Public sector was thus seen as an active agent of resource mobilisation for undertaking large, coordinated investments (considered the 'Big Push' necessary to jumpstart the economy). As a result, between 1950 and 1965, public sector capital formation, as a percentage of GDP, more than doubled from 3.1 to 7.5. However, in the later years, not only did planning lose its bite, but also the public sector's capacity for resource mobilisation severely declined. Declining public investment from the mid-1960s was instrumental in a growth slowdown that lasted till the late-1970s. Thus, from a position occupying the commanding heights of the economy, the public sector degenerated into an employment-granting welfarist role agency.

2.4.2 Increasing Role of Market (Phase II)

India has since come a long way in terms of shredding traces of its short term vision by accepting the principle of the primacy of market for its economic management. This can be seen by comparing the key features of reforms adopted initially in the 1980s and pursued vigorously during the 1990s.

The key features of reforms initiated in the 1980s are : (i) liberalisation of imports (especially of capital goods and intermediate inputs); (ii) extension of export incentives through the tax system and liberal access to credit and foreign exchange; (iii) significant relaxation of industrial licensing requirements through direct 'de-licensing' of some industries and through 'broad banding' (i.e. permitting firms in some industries to switch production between similar product lines); and (iv) decontrol of administered prices for key intermediate inputs. In light of these important changes, the reforms of the 1980s, came to be characterised as 'pro-market' in orientation.

The reforms of the 1990s, which are distinguished from the reforms of the 1980s, include: (i) abolition of industrial licensing and narrowing the scope of public sector monopolies to a much smaller number of industries; (ii) liberalisation of inward foreign direct and foreign portfolio investment; (iii) sweeping liberalisation of trade with the elimination of import licensing and progressive reduction of non-tariff barriers; (iv) financial sector liberalisation including the removal of controls on capital issues (e.g. allowing foreign private banks to operate in the economy, opening up of insurance sector); (v) liberalisation of investment policies in import of services such as telecommunications; etc.

Countries in general are moving away from the role of state as a producer of goods and services. A major reason for the emergence of skepticism regarding the benefits of state intervention has been the growing perception that government failures on account of political interference and bureaucratisation may, in many cases, exceed market failures. Given the importance of incentive reward system in achieving consistent improvement in efficiency, on balance, it is well acknowledged that markets provide a better incentive for many economic activities to be run on a corporate style by the private sector. Closely related to these institutional factors is also the belief that a competitive environment creates a better climate conducive to enhancing efficiency.

The decreasing role of state as a producer of goods and services and the increasing primacy accorded to market forces enhances the role of state from being a 'regulator' to that of a 'facilitator'. As a general rule, markets must be allowed to function freely wherever price signals clearly work in achieving efficiency. State investment becomes necessary only in areas where markets do not exist or where they cannot perform efficiently.

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Check Your Progress 1 [answer within the space given in about 50-100 words]

1) How is development distinct from growth?

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2) What is the basic assumption requiring to be met for the success of market based approach to development?

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3) What is the rationale behind the state led development strategy?

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4) What is meant by 'inclusive growth' strategy?

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5) What is the essence of the 'sustainable development' (SD) approach?

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6) Define the term 'mixed economy'.

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7) What empirical indicator can you cite to demonstrate the leading role assumed by the public sector in the initial years of planning in India? What trend did this indicate in the later years?

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8) What are the major reforms introduced in the 1990s to characterise the change in developmental approach as one of 'pro-market'?

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2.5 INTEGRATION WITH THE GLOBAL ECONOMY

To what extent has India integrated itself with the rest of world? Has the pace of integration quickened since the beginning of economic reforms in the early 1990s? Integration can be measured by quantifiable variables such as trade to GDP ratio, mean tariff rate, diversification of exports, FDI inflow as percentage of GDP, etc. We take a brief look at the trends in these variables below.

2.5.1 Trade GDP Ratio

Countries that are highly integrated in the world economy tend to exhibit a high trade to GDP ratio. An indicator of extent of integration is provided by the two 'trade orientation ratios' (TOR) viz. (i) share of exports in total GDP; and (ii) combined share of exports and imports to GDP. Economic reforms over the years have made India a much more open economy. The share of Indian exports of goods and services in its total GDP has increased from 6.5 percent in 1991-92 to 19.1 percent in 2013-14. The combined share of exports and imports of goods as a percentage of GDP at market prices has increased from 13.6 percent in 1991-92 to about 46.5 percent in 2013-14. Despite these significant increases, India's share in global merchandise exports has increased slightly from around 0.6 percent in 1993 to 1.7 percent in 2014. Likewise, India's share in global imports has also modestly increased from around 0.6 percent in 1993 to 2.4 percent in 2014 (Table 2.1).

Table 2.1: Exports and Imports (%) by Countries/Regions in Merchandise

Country	Export Share		Import Share	
	1993	2014	1993	2014
Asia	26	32	23.5	31.5
China	2.5	12.7	2.7	10.5
Japan	9.8	3.7	6.4	4.4
India	0.6	1.7	0.6	2.5
Six East Asian traders	9.6	9.6	10.2	9.4

Source: WTO, International Trade Statistics, 2015

2.5.2 Mean Tariff Rate

Another indicator for measuring a country's integration with the rest of the world is through estimation of a country's mean tariff rate. The mean tariff rate for all products in India has declined from 80 percent in 1990 to 6.3 percent in 2012.

2.5.3 Diversification of Exports

Countries that are more integrated into the world economy experience not only rapid export growth but also export diversification. During the initial years of liberalisation, India's exports were less diversified with top 20 countries accounting for more than 80 percent of India's total exports. Today (2017), the corresponding percentage with the top 20 export destinations account for 67 percent of total exports reflecting greater diversification.

2.5.4 Product Composition of Exports

Another indicator of integration is how much a country is moving away in its exports from traditional and primary products into high-value-added exports. This is reflected in the share of technologically-advanced goods in manufactured exports. There is a major shift in India's exports, away from primary products like textiles towards more value added items like engineering goods, refinery products, pharmaceuticals, etc. Thus, India's export basket is now more diversified with non-traditional items which include: engineering goods accounting for 23 percent in India's total exports in 2014-15.

2.5.5 Direction of Exports

A significant change in India's exports during post-liberalisation era has been the increasing share of developing countries compared to the share of developed economies. Between 1990-91 and 2014-15, the share of Asia has increased from 34 to 49 percent and that of Africa from 3 percent to 11 percent. On the other hand, share of Europe has come down from 41 percent to 19 percent during this period.

2.5.6 Financial Integration

The level and pace at which the inflow of FDI increases serve as an important indicator of financial integration. The net inflow of FDI as a percentage of GDP has increased from 0.03 percent in 1991 to 1.96 percent in 2016.

Check Your Progress 2 [answer within the space given in about 50-100 words]

1) In terms of two TORs (trade orientation ratios), how does the integration of Indian economy with the rest of the economy figure?

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2) In terms of what other specific respects, can the integration of Indian economy with the rest of the world be specified?

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3) How is financial integration of an economy measured? What has been the position in this respect for India?

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2.6 LET US SUM UP

The approach to development has steadily shifted from state led approach to market based approach. In the initial stages of development, due to poor infrastructural base and high degree of concentration in the production of primary products, a developing economy will be required the assistance of state for its investment. In other words, the development of markets would be inadequate to rely on the price signals for achieving the developmental goals. This feature has commonly influenced all major economies to pursue in their initial stages of development a policy of state led growth. India too embarked on this approach experimenting with the same for close to four decades from 1950 to 1990. However, the ability of public sector to mobilise resources required for expansion of economy declined sharply right after the late 1960s. Concerns of sustainable development also became critical in policy planning in India as was the goal for aiming 'inclusive development'. The result was a change in approach to development from a controlled public sector led regime to a market based approach in the 1990s. The polices implemented in the last two decades have seen an appreciable increase in the ratio of 'exports plus imports to GDP' from 14 percent in 1992 to 47 percent in 2014. Despite this steep increase, in terms of overall share of total global exports, India's share has marginally moved up to reach 1.7 percent in 2014 (from 0.6 percent in early 1990s). Thus, in spite of improvements in geographic and product composition diversification, lowering of 'mean tariff rate', etc., in terms of financial integration measured by 'percentage inflow of FDI to GDP' India's level is low at below 2 percent in 2016.

2.7 SOME USEFUL BOOKS

1) Chakravarty, Sukhamoy (1987). 'Development Strategies in the Asian Countries' In Louis Emmerij (ed.), *Development Policies and the Crisis of the 1980s.* OECD.

2) FICCI (2016). Economy Insights – Trends in India's Foreign Trends, May, 2016.

3) Balakrishnan, P (2010). Economic Growth in India: History and Prospect, Oxford University Press.

4) Basu K. (Ed.) (2008). *The Oxford Companion to Economics in India,* Oxford University Press, USA.

5) Bhattacharya D (1993). *The Political Economy of Development,* Academic Publishers.

6) Perkins D. H., Radelet S., Lindauer D. L., & Steven A (2013). Economics of Development, W.W. Norton and Company, New York.

2.9 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) Growth relates to increase in only income like NI or per capita income. Development takes into account the distributional dimension of growth in income relating the spread to how far the benefits of growth have reached the marginalised sections in terms of their education and health needs. It also includes aspects like industrialisation and urbanisation.

2) The approach assumes conditions of well developed competitive markets with signals of price and profits to be available for their efficient functioning i.e. optimum production with minimum resource inputs leading to faster growth.

3) The rationale is one of 'big push' required under conditions of underdevelopment like subsistence agriculture, weak industrialisation, etc. In such situations, state led heavy investment in key sectors of economy through planned mobilisation and allocation of resources to public sector institutions/enterprises was held as the key.

4) The inclusive growth strategy implies that the benefits of growth realised in terms of increase in national income should percolate downwards to the lowest rungs of society reaching or in a way as to 'not exclude' the marginalised sections of society. This requires institutional arrangements to ensure the equitable distribution of the gains of growth which needs to ensured only by the state.

5) The SD approach underlines two essentials of: (i) protecting the interest of the world's poor from the exploitation of natural resources which impinges on the livelihood statuses of the poorer sections to be duly accounted and compensated; and (ii) limitations of technology and social organisations in abetting the exploitation of natural resources to be duly accounted for.

6) The term refers to the coexistence of both the public and the private sectors combining the state with the market in a mutually reinforcing manner.

7) The public sector investment as a percentage of GDP rose from 3.1 percent to 7.5 percent over the years 1950-65. In the later years, the ability of the public sector to mobilise resources declined so sharply that its role came to be described as 'employment granting and welfarist'.

8) The measures are: (i) abolition of industrial licensing; (ii) liberalisation in the inward flow of foreign direct and portfolio investment; (iii) trade liberalisation with elimination of import license and progressive reduction of non-tariff barriers; (iv) financial sector liberalisation like allowing the opening of foreign private sector banks and the insurance sector; and (v) liberalisation of investment policies in import of services like telecom.

Check Your Progress 2

1) In terms of only total exports to total GDP, the percentage ratio has increased from 6.5 percent in 1991-92 to 19.1 percent in 2013-14 (i.e. an increase of close to 3 times). In terms of combined share of 'exports plus imports' to total GDP, it has increased from 14 percent to 47 percent over the corresponding period (i.e. an increase of 3.4 times). Despite this increase, India's share in global exports has increased from 0.6 percent to 1.7 percent only (i.e. although the increase is once again close to 3 times, the ratio is still very meagre).

2) In terms of mean tariff rate, there is a drastic decrease from 80 percent in 1990 to 6.3 percent in 2012. In terms of product diversification defined as the percentage of exports to top 20 countries, the ratio has fallen from 80 percent to 67 percent. The share of engineering exports, in the total exports has risen to 23 percent in 2014-15.

3) Financial integration is measured in terms of the percentage increase in FDI inflow to GDP. For India, this has increased from 0.03 percent in 1991 to 1.96 percent in 2016.

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