

Lecture 1

Introduction

In this course, we will study the most important and complex economic issue: the economic transformation of developing countries into developed countries. Most of the countries in the world are classified as developing countries and majority of people in the world live in these countries. Over 40 percent of the world's population lives in poverty, on less than \$2 per day.

There is a great contrast between living standards of people inhabiting developing countries and developed countries. People in developing countries have low income, live in poor conditions and lack access to reliable and good health and education facilities. Many people in these countries are even deprived of basic necessities of life such as food, good shelter, and safe drinking water. In the developed countries, most of us take basic amenities of life such as food, shelter, access to education and health services as granted.

In this course we will study questions such as (i) why are so many people have low standards of living and what are their characteristics? (ii) What are the major impediments to the development process? (iii) What policies can be adopted to increase the standards of living? (iv) What is the role of globalization and foreign aid in the process of development?

Definition of Economic Development

Development is the process of structural transformation. Development economics is the study of transformation of economies: transformation of agrarian and rural economies to urban and modern economies, one with dominant traditional sector to one with dominant modern sector, one with population of low skills to one with high skills and one with underdeveloped and informal markets and institutions to one with developed and formal markets and institutions. It analyzes factors constraining and inhibiting the process of structural transformation and studies policies and strategies which can facilitate such transformation.

Measurement Issues

How do we distinguish between developing countries and developed countries? How do we measure level of development? There are many ways to distinguish between developing and developed countries and measuring development. However, the issue of measuring development has been controversial and our thinking has evolved over time.

The most common and widely used measure of development is per-capita income of a country. Per-capita income is an indicator of purchasing power of inhabitants of a country. It gives a measure of how much goods and services inhabitants of a country can purchase. There are two measures of per-capita income which are commonly used: one based on **gross national income (GNI)** and other based on **gross domestic product (GDP)**. Both GNI and GDP measure the overall level of economic activity and are closely related. GDP is the total value of the final output of goods and services produced in a country. GNI is simply GDP plus net flows of foreign factor income. Per-capita income is usually proxied by either GNI per capita or GDP per capita.

According to this definition, developing countries are countries with low per-capita income. The problem of economic development is simply to increase the per-capita income of developing countries, which is essentially the problem of growth.

One major problem with using per-capita income is that such per-capita income comparison exaggerates the differentials in standards of living between developing and developed countries. Recall that what matters for the well-being is the amount of goods and services one can purchase. The amount of goods and services one can purchase depends on two things: income and the price level. Same amount of income buys fewer goods and services if prices are high compared to the case when prices are low.

For example, suppose that there are two individuals A and B. Both have identical incomes say \$1000. Now suppose that A lives in a country where price level is 50, but B lives in a country where price level is 100. Then, A can buy 20 units of good, while B can buy only 10 units of goods. Thus, despite identical incomes A will have higher standard of living than B.

This implies that if we ignore differences in price level across countries, then just the comparison of per-capita income across countries can give misleading picture of differences in the standards of living. It turns out that on average prices in developing countries are lower than prices in developed countries. One dollar spent in India buys more goods and services than in the United States. The main reason for lower prices in developing countries is relatively low labor cost.

Researchers have tried to take into account such price differences across countries and developed the concept of purchasing power parity (PPP). PPP is calculated using a common set of international prices for all goods and services produced, valuing goods in all countries at U.S. prices. PPP is defined as the number of units of a foreign country's currency required to purchase the identical quantity of goods and services in the local markets as \$1 would buy in the United States.

The World Bank defines low-income countries (LIC) as having a per-capita gross income of \$ 875 or less in 2005 and high-income countries having income of \$ 10,726 or more. Countries with income of \$ 875 and more but less than \$ 3,465 are classified as lower middle income countries (LMC) and countries with income between \$3,465 and \$10, 726 are classified as upper middle-income countries (UMC). All the countries other than high income countries are classified as developing countries.

Most of the high income countries are located in Western Europe and North America. On the other hand, most of the low-income countries are located in Africa and Asia. Population wise the largest concentration of low income people is in South Asian countries. Most of the countries in South America and Eastern Europe are middle income countries.

Many economist and social scientists believe that defining developing countries just on the basis of per-capita income is very narrow and can be misleading. As discussed earlier, economic development is the process of structural change. Changes in per-capita income do not reflect structural change. One may have high growth rate in per-capita income without any structural transformation.

Their views received a great deal of support from the growth experience of developing countries in the 50s and 60s. In these decades, many developing countries focused on increasing their per-capita income rapidly as a way to get out of underdevelopment. The belief was that `` rising tide lifts all boats” i.e. growth benefits everybody. They concentrated their resources in developing few sectors with most growth potential assuming that development in one sector will automatically spread to other sectors.

Many developing countries did reach their economic growth targets but the levels of living of the masses of people remained for the most part unchanged. Economic growth did benefit tiny section of the society, but majority of people remained mired in poverty i.e. growth did not trickle down to masses.

The growth experience of developing countries in the 50's and the 60's led to major rethinking about the concept of economic development. It was realized that problems of poverty, inequality, and institutional changes require direct attack and policy interventions. It led to the view that development is a multidimensional process involving major changes in social structures, attitudes, institutions as well growth and redistribution. Development is more concerned with enhancing the lives people lead and the freedoms they enjoy. Income and wealth are not in ends in themselves but instruments for other purposes.

The current approach to development owes a great deal to the writings and views of Noble Laureate Dr. Amartya Sen. As Sen put it, “*Economic growth cannot be sensibly treated as an end in itself. Development has to be more concerned with enhancing the lives we lead and the freedoms we enjoy.*” This new approach is popularly known as Sen’s **Capabilities Approach**.

According to this approach, development is not just about increasing the availability of commodities (focus of the per-capita income approach) but expanding the capabilities of individuals to use these commodities and enhancing the freedom of choice of people. Higher income is important an element of one’s well being. But, well being of individuals also depends on their health, education, geographical and social environment, and political system. There are three core values of development: (i) sustenance, (ii) self-esteem, and (iii) freedom.

Sustenance: Sustenance is the ability to meet basic needs of people. All people have certain basic needs without which life would be impossible. These basic needs include food, shelter, health, and protection. People should have access to these basic needs.

Self-Esteem: Sense of worth and self-respect and feeling of not being marginalized are extremely important for individual’s well being. All peoples and societies seek some form of self-esteem (identity, dignity, respect, honor etc.). The nature and form of self-esteem may vary from on culture to another and from time to time. Self-esteem may be based on material values: higher income or wealth may be equated with higher worthiness. One may consider individuals worthy based on their intellect or public service.

Freedom from Servitude: Human freedom, the ability to choose, is essential for the well being of individuals. Freedom involves an expanded range of choices for societies: economic and political. It involves freedom from bondage, serfdom, and other exploitative economic, social, and political relationships.

The new view about the development process suggests that one cannot capture the process of development by just per-capita income. It cannot reflect the multidimensional nature of development process. In recent years, a number of different types of measures have been developed to better reflect the multidimensional nature of development process. In next few lectures, we will study extensively some of these new measures. We will see that these measures are much better than per-capita income in reflecting the development process and quality of life. However, these are still evolving and should be taken as work in progress.

Next we very briefly discuss the Human Development Index (HDI), which is right now the most prominent indicator of the socio-economic development of countries.

Human Development Index (HDI)

Human development index is an attempt to capture the broader view of development that development involves not only increase in per-capita income but also expansion of the capabilities of individuals. Human capital in terms of education and health is one of the most important determinant and indicator of capability of an individual. They capture important aspects of socioeconomic development of countries and the well being of individuals.

In 1990, the United Nations Development Program (UNDP) developed an index which reflects development in per-capita income as well as human capital. This new index is known as Human Development Index (HDI) and is published annually by the UNDP in their Human Development Reports.

The concept of human development is still evolving. Over time there have been changes in its methodology. Till 2009, HDI was calculated as follows.

Original HDI had three components. The first was life-expectancy at birth, which captures longevity and status of health. It also indirectly reflects infant and child mortality rates. The second was the measure of educational attainment of the society. Educational attainment was measured as a weighted average of adult literacy (with weight 2/3) and a combination of enrollment rates in primary, secondary, and tertiary education (weight 1/3). The last component was the per-capita income. All three components (health, education, and income) were combined to produce HDI score of a country. All three components were given equal weight in the construction of HDI score.

The value of HDI varies between 0 and 1. Countries with higher HDI score are considered to be more developed. The UNDP classified low HD countries as countries with HDI score below 0.5. Countries with HDI score of 0.9 and above were classified as very high HD countries. Countries with HDI score of 0.8 and above and below 0.9 were classified as high HD countries. Countries with score of 0.5 and above and below 0.8 were classified as medium HD countries.

Starting 2010, the UNDP has changed its methodology to calculate the HDI. We will study these changes in the next lecture.

The Millennium Development Goals

In September 2000, the 189 member countries of the United Nations adopted eight Millennium Development Goals (MDGs) committing themselves to eradicate extreme forms of deprivation by 2015. These goals aimed at substantially reducing poverty,

improving accessibility to educational and health facilities and reducing gender inequality and empowering women. The eight goals and the associated targets are given in table 1.








These goals represent one of the most substantive international effort and commitment to improve the living standards of poor people. However, the MDGs have been criticized on various grounds. Firstly, many critics argue that the goals and targets are not ambitious enough. It merely represents the past rates of improvement witnessed in the 80's and 90's. Secondly, goals are not prioritized. For example, reducing hunger is likely to improve health status and educational attainment. Thus, the goal of reducing hunger should be given higher priority. Thirdly, classifying people living on less than \$ 1 a day as extremely poor is quite arbitrary. Despite all these criticisms MDGs do represent an ambitious and sensible effort by world community to fight poverty and achievement of these goals is going to significantly improve the living standards of people.

It is now ten years since the declaration of the MDGs. What have been the achievements so far? The performance seems to be mixed. Some countries such as India and China are doing very well. But many countries in Africa have mixed results. It seems that many countries will miss their targets in the areas of maternal health, sanitation, poverty reduction, child mortality, and environment. There are number of reasons for lack of adequate progress in such areas: (i) lack of political will (ii) lack of resources such as hospitals, trained staff (iii) corruption and (iv) lack of information.

Please see ``The Eight Commandments'' published in The Economist, July 7th, 2007 for a very informative discussion.

Table 1

Millennium Development Goals

Goals	Targets
 <p>1. Eradicate extreme poverty and hunger</p>	<ul style="list-style-type: none"> • Reduce by half the proportion of people living on less than \$1 a day • Reduce by half the proportion of people who suffer from hunger
 <p>2. Achieve universal primary education</p>	<ul style="list-style-type: none"> • Ensure that all boys and girls complete a full course of primary schooling
 <p>3. Promote gender equality and empower women</p>	<ul style="list-style-type: none"> • Eliminate gender disparity in primary and secondary education, preferably by 2005, and at all levels by 2015
 <p>4. Reduce child mortality</p>	<ul style="list-style-type: none"> • Reduce by two-thirds the mortality rate among children under 5
 <p>5. Improve maternal health</p>	<ul style="list-style-type: none"> • Reduce by three-quarters the maternal mortality ratio
 <p>6. Combat HIV/AIDS, malaria, and other diseases</p>	<ul style="list-style-type: none"> • Halt and begin to reverse the spread of HIV/AIDS • Halt and begin to reverse the incidence of malaria and other major diseases
 <p>7. Ensure environmental sustainability</p>	<ul style="list-style-type: none"> • Integrate the principles of sustainable development into country policies and programs; reverse loss of environmental resources • Reduce by half the proportion of people without sustainable access to safe drinking water • Achieve significant improvement in lives of at least 100 million slum dwellers by 2020



8. Develop a global partnership for development

- Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system; includes a commitment to good governance, development, and poverty reduction—both nationally and internationally
- Address the special needs of the least developed countries; includes tariff and quota free access for least developed countries' exports; enhanced program of debt relief for heavily indebted poor countries (HIPC) and cancellation of official bilateral debt; and more generous official development assistance (ODA) for countries committed to poverty reduction
- Address the special needs of landlocked countries and small island developing states
- Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term
- In cooperation with developing countries, develop and implement strategies for decent and productive work for youth
- In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries
- In cooperation with the private sector, make available the benefits of new technologies, especially information and communications

Source: United Nations Development Program, "Millennium Development Goals," <http://www.undp.org/mdg/goallist.shtml>, Aug. 16, 2007.

