**Development Theory and Policy**

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| **Course Title** | Development Theory and Policy |
| **Course Code** | PPM 511 |
| **Credit Hours** | 2 |
| **Classification** | Core |
| **Semester** | Year 1, Semester 1 |
| **Description** | In many developing countries, the benefit of development has, by and large, bypassed the poor and marginalized. The course, therefore, deals with the basic understanding of the concepts and theories of development, processes of development planning and strategies and performance of development programs. The course focuses on the various theories, approaches and practical examples in development planning and policy. More importantly, it deals with, among others, growth theories, models and approaches, development policies, programs and projects pertinent to developing country contexts. |
| **Objective** | The main objectives of this course are to:   * equip students with detailed theoretical and applied knowledge of development theory and policy, * familiarize students with dynamic growth and development models relevant for policy in the Ethiopian context, and * Enhance students’ knowledge that enables them to analyze theoretical and applied development planning models and policy issues. |
| **Course Content** | Economic Development: Concept, Approaches and Measurement  * 1. Conceptualization of economic growth and development   2. Traditional and modern economic measures   3. Basic indicators and holistic measures of development   4. Objectives of development  Characteristics of Developing World  * 1. Defining the Developing World and structural features   2. Basic Indicators of Development & Holistic Measures of Living Standards   3. Dominance and Structure of Informal Market and Vulnerability to Shocks   4. Dualism of Financial and Labour Market   5. Agrarian Based Economics and Transforming African Economics  Theories of Economic Growth and Development  * 1. Classic Theories of Economic Growth and Development   2. Growth Models (Endogenous vs Exogenous; Balanced vs Unbalanced, and Inward Vs Outward Looking Growth)   3. Contemporary Models of Development and Underdevelopment   4. Empirical Applications of Development Models to African and Ethiopian Economy: Examinations  Economic Growth, Poverty, and Inequality  * 1. Conceptualization of Income Distribution and Development   4.2 Measuring inequality  4.3 Poverty, Inequality, and Social Welfare  4.4 Characteristics of high-poverty groups  4.5 Policy Options on Income Inequality and Poverty Factors of Development: More Focus on Population Theory  * 1. Natural resource endowment   2. Population growth and labour market   3. Capital formation and foreign investment   4. Population Growth and Development: Causes, Consequences, and Controversies   5. Technological progress, Efficiency: Total Factor Productivity |
| **Mode of Delivery** | The method of delivery will combine different approaches including lectures, collaborative learning activities and independent study in order to appeal to the learning styles of different students. |
| **Method of Assessment** | The entire examination of this course will consist of both a continuous assessment and exams. The grades will be determined as follows:     * 1. Midterm Exam 15%   2. Projects and Presentation 20%   3. Journal Review and Presentation 15%   4. Final Exam (as scheduled by the university) 50% |
| **Reading List** | *Major reading/text*   1. Todaro, M. P., Smith, S.C. (2011). *Economic Development*. (11th Ed.). Pearson, Addison Wesley. 2. Jingan 3. Ray, Debraj. (1998). *Development Economics*. Princeton, NJ: Princeton University Press. 4. Jha, S. N. And Mathur, P.C. (1999). *Decentralization and Local Politics.* New Delhi: Sage Publications 5. Baum, Warren C. And Stokes M. Tolbert (1985). Investing in Development: Lessons of World Bank Experience, New York, Oxford University Press. |

# Chapter One

# Economic Development: Concept, Approaches and Measurement

**Poverty** results from **extreme** **inequalities**.

**Poor people** are poor because **rich people** take so much of the income what the economy produces.

## Conceptualization of economic growth and development

Development can be seen . . . as a process of expanding the real freedoms that  
people enjoy. *—Amartya Sen, Nobel laureate in economics*

Development means making a better life for everyone. In the present context of a highly uneven world, a better life for most people means, essentially, meeting basic needs: sufficient food to maintain good health; a safe, healthy place in which to live; affordable services available to everyone; and being treated with dignity and respect.

**Development:-**The process of improving the quality of all human lives and capabilities by raising people’s levels of living, self-esteem, and freedom.

**Developing countries:-** Countries of Asia, Africa, the Middle East, Latin America, eastern Europe, and the former Soviet Union, that are presently characterized by low levels of living and other development deficits. Used in the development literature as a synonym for less developed countries.

Although development economics often draws on relevant principles and concepts from other  
branches of economics in either a standard or modified form, for the most part it is a field of study that is rapidly evolving its own distinctive analytical and methodological identity.

**Traditional economics:-** An approach to economics that emphasizes utility, profit maximization, market efficiency, and determination of equilibrium.

**Political economy:-** The attempt to merge economic analysis with practical politics—to view economic activity in its political context. Political economy is therefore concerned with the relationship between politics and economics, with a special emphasis on the role of power in economic decision making.

**Development economics** has an even greater scope. In addition to being concerned with the efficient allocation of existing scarce (or idle) productive resources and with their sustained growth over time, it must also deal with the *economic, social, political*, and *institutional* mechanisms, both public and private, necessary to bring about *rapid* (at least by historical standards) and *large-scale improvements* in levels of living for the peoples of Africa, Asia, Latin America, and the formerly socialist transition economies. Unlike the **more developed countries (MDCs)**, in the **less developed countries**, most commodity and resource markets are highly imperfect, consumers and producers have limited information, major structural changes are taking place in both the society and the economy, the potential for multiple equilibria rather than a single equilibrium is more common, and disequilibrium situations often prevail (prices do not equate supply and demand).

Thus development economics, to a greater extent than traditional neoclassical economics or even political economy, must be concerned with the economic, cultural, and political requirements for effecting rapid structural and institutional transformations of entire societies in a manner that will most efficiently bring the fruits of economic progress to the broadest segments of their populations. It must focus on the mechanisms that keep families, regions, and even entire nations in poverty traps, in which past poverty causes future poverty, and on the most effective strategies for breaking out of these traps.

Consequently, a larger government role and some degree of coordinated economic decision making directed toward transforming the economy are usually viewed as essential components of development economics.

Development economics is a field on the crest of a breaking wave, with new theories and new data constantly emerging. These theories and statistics sometimes confirm and sometimes challenge traditional ways of viewing the world.

**Three Core Values of Development**

These core values—**sustenance**, **self-esteem**, and **freedom**—represent common goals sought by all individuals and societies.

**Sustenance** The basic goods and services, such as food, clothing, and shelter, that are necessary to sustain an average human being at the bare minimum level of living.

**Self-esteem** The feeling of worthiness that a society enjoys when its social, political, and economic systems and institutions promote human values such as respect, dignity, integrity, and self-determination.

**Freedom** A situation in which a society has at its disposal a variety of alternatives from which to satisfy its wants and individuals enjoy real choices according to their preferences.

**Growth** is generally necessary, though not sufficient, for achieving development.

**Components of Economic Growth**Three components of economic growth are of prime importance:  
1. Capital accumulation, including all new investments in land, physical equipment, and human resources through improvements in health, education, and job skills

2. Growth in population and hence eventual growth in the labor force

3. Technological progress—new ways of accomplishing tasks

**Capital accumulation:-** Increasing a country’s stock of real *capital* (net *investment* in fixed assets). To increase the production of capital *goods* necessitates a reduction in the production of consumer goods.

**Capital stock:-** The total amount of physical goods existing at a particular time that have been produced for use in the production of other goods and services.

**Economic infrastructure:-** The amount of physical and financial capital embodied in roads, railways, waterways, airways, and other transportation and communications plus other facilities such as water supplies, financial institutions, electricity, and public services such as health and education.

**Development:-** is a founding belief of modernity. And modernity is that time in Western history when rationality supposed it could change the world for the better. In development, all the modern advances in science and technology, in democracy and social organization, in rationalized ethics and values, fuse into the single humanitarian project of deliberately and cooperatively producing a far better world for all.

In this modernist tradition, the radical version of “development” is fundamentally different from the more conventional “economic growth.” Economic growth means achieving a more massive economy—producing more goods and services on the one side of the national account (gross domestic product—GDP)—and a larger total income on the other (gross national income—GNI). But economic growth can occur without touching problems like inequality or poverty when all the increase goes to a few people. Indeed, growth has occurred in most Western countries over the past 30 years at the same time that income inequality has widened. In this case, economic growth functions, in the most basic sense, to channel money and power to the already rich and famous. This is fine if you are rich, and even better if you are famous. But for developmentalists this feeding of money to the already wealthy is a travesty of ethics and a tragedy of modern economic practice. The excuses for it, like “trickle down” (eventually everyone benefits from growth as income trickles down from the rich) are not convincing except to those already convinced by their complete adherence to an elite society. Because of social and environmental reasons, growth is justified only when it produces development— when it satisfies essential needs.

As this suggests, development is interested not so much in the growth of an economy but rather the conditions under which production occurs and the results that ﬂow from it. In terms of conditions, development pays attention to the environments affected by economic activity and the labor relations and conditions of the actual producers of wealth— the peasants and workers who produce growth. If growth wrecks the environment, and if growth deadens working life, it is not development.

Development looks too at what is produced. If growth merely produces more Wal-Mart junk rather than schools or clinics, it is not development. Development attends to the social consequences of production. If growth merely concentrates wealth in the hands of a few, it is not development. Most contentiously, development analyses who controls production and consumption. If the growth process is controlled by a few powerful people rather than the many people who make it possible, it is not development. If growth means subjecting the world’s people to an incessant barrage of consumption inducements that invade every corner of life, it is not development. If growth is the outcome of market processes that no one controls—although a few people benefit—it is not development. Development is optimistic and utopian. Development means changing the world for the better. Development means starting change at the bottom rather than the top.

Development entails human emancipation, in two of the senses of the word: liberation from the vicissitudes of nature, through greater understanding of earth processes followed by carefully applied technology; and self-emancipation, control over social relations, conscious control over the conditions under which human nature is formed, rational and democratic control over the cultural production of the human personality. (Is the greatest tragedy of modernity the loosening of social control over the production of subjectivity to people and institutions with the worst of motives—like ad agencies, for instance?) In both senses, external and internal, development entails economic, social, and cultural progress, including, in the latter sense, finer ethical ideals and higher moral values. Development means improvement in a complex of linked natural, economic, social, cultural, and political conditions. Developmentalism is the belief in the viability and desirability of this kind of economic progress. A good example might be Amartya Sen’s *Development as Freedom* (2000), concerned with how society grants to individuals the capacity for taking part in creating their own livelihoods, governing their own affairs, and participating in self government—although we do not find him following this through with a political economics of societal transformation. In brief, development is quite different from growth. Development springs from the most optimistic moment of the modern rational belief, whereas mere growth is practical, technological, but also class-prejudiced thought.

## Traditional and modern economic measures

Unlike the **more developed countries (MDCs)**, in the **less developed countries**, most commodity and resource markets are highly imperfect, consumers and producers have limited information, major structural changes are taking place in both the society and the economy, the potential for multiple equilibria rather than a single equilibrium is more common, and disequilibrium situations often prevail (prices do not equate supply and demand). In many cases, economic calculations are dominated by political and social priorities such as unifying the nation, replacing foreign advisers with local decision makers, resolving tribal or ethnic conflicts, or preserving religious and cultural traditions. At the individual level, family, clan, religious, or tribal considerations may take precedence over private, self-interested utility or profit-maximizing calculations.

It must focus on the mechanisms that keep families, regions, and even entire nations in poverty traps, in which past poverty causes future poverty, and on the most effective strategies for breaking out of these traps. Consequently, a larger government role and some degree of coordinated economic decision making directed toward transforming the economy are usually viewed as essential components of development economics.

**Subsistence economy:-** An economy in which production is mainly for personal consumption and the standard of living yields little more than basic necessities of life—food, shelter, and clothing. In strictly economic terms, *development* has traditionally meant achieving sustained rates of growth of **income per capita** to enable a nation to expand its output at a rate faster than the growth rate of its population. Levels and rates of growth of “real” per capita **gross national income (GNI)** (monetary growth of GNI per capita minus the rate of inflation) are then used to measure the overall economic well-being of a population—how much of real goods and services is available to the average citizen for consumption and investment.

## Basic indicators and holistic measures of development

**Basic Indicators of Development: Real Income, Health, and Education**

Basic indicators of three facets of development: real income per capita adjusted for purchasing power; health as measured by life expectancy, undernourishment, and child mortality; and educational attainments as measured by literacy and schooling.

Development is important because it produces an economy, and more broadly a society and culture, that determines how people live—in terms of income, services, life chances, education, and so on. As we have said, “development” is conventionally measured as economic growth, with “level of development” seen in terms of “size of the economy.” The size of a nation’s economy, under what is called the “income approach” to accounting, is derived from totaling the wages, rents, interest, profits, non-income charges, and net foreign factor income earned by that country’s people—thus, the gross national income (GNI) is basically what everyone earns. Total expenditures on goods and services must, by definition, in this kind of national accounting practice be equal to the value of the goods and services produced, and this must be equal to the total income paid to the factors (workers, shareholders, etc.) that produced these goods and services. Thus, gross national product (GNP) is the total value of final goods and services produced in a year by a country’s residents (including profits from capital held abroad). Nominal GNP measures the value of output during a given year using the prices prevailing during that year. Over time, the general level of prices tends to rise due to inflation, leading to an increase in nominal GNP even if the volume of goods and services produced is unchanged. So, real GNP measures the value of output adjusted for inflation. When economic growth over a number of years is measured, change in “real GNP” is the figure usually used to express that growth. Dividing the GNP or GNI by a country’s population yields the GNP or GNI per capita. In general, the higher the per capita production or income, the more “developed” a country’s people are conventionally said to be, and the higher the annual growth rate per capita, the more rapidly a country is said to be developing.

An alternative summary measure that takes these into account is the Human Development Index (HDI) calculated by the United Nations Development Program (UNDP). This measure derives from a different conception of development than that usually presented—what the UNDP calls “enlarging people’s choices,” especially in terms of access to knowledge, nutrition and health services, security, leisure, and political and cultural freedoms. The HDI measures development in terms of longevity (life expectancy at birth), knowledge (adult literacy and mean years of schooling), and income suffciency (the proportion of people with sufficient resources for a decent life). In 2007–2008 the countries at the top of this index were, in order, Iceland, Norway, Australia, Canada, Ireland, Sweden, Switzerland, Japan, Netherlands, France, Finland, and the United States—all scoring over 0.9 out of a maximum of 1.0 (the United Kingdom ranked 16th and New Zealand 19th; UNDP 2008). An HDI score below 0.5 represents low development, and 29 of the 31 countries in that category are located in Africa, the others being Haiti and Yeman. The lowest-ranked HDI countries are Sierra Leone, Burkina Faso, Guinea-Bissau, and Niger (UNDP 2008).

## Objectives of development

**The Three Objectives of Development**

We may conclude that development is both a physical reality and a state of mind in which society has, through some combination of social, economic, and institutional processes, secured the means for obtaining a better life. Whatever the specific components of this better life, development in all societies must have at least the following three objectives:

1. *To increase the availability and widen the distribution of basic life-sustaining goods* such as food, shelter, health, and protection

2. *To raise levels of living*, including, in addition to higher incomes, the provision of more jobs, better education, and greater attention to cultural and human values, all of which will serve not only to enhance material wellbeing but also to generate greater individual and national self-esteem.

3. *To expand the range of economic and social choices* available to individuals and nations by freeing them from servitude and dependence not only in relation to other people and nation-states but also to the forces of ignorance and human misery.

In 1960 the 20% of the world’s people living in the richest countries had 30 times the income of the 20% of the world’s people living in the poorest countries; in 1973 the figure was 44 to 1; and in 1997 the ratio was 74 to 1 (United Nations Development Program 1999: 36–38). As statisticians find out more about it, the world is turning out to be even more unequal than was previously thought, both in terms of the differences among countries and the differences among groups of the world’s people. National poverty rates in the low-income countries lie in the range of 45–70% of the population, while the percentage of people living on less that $2 a day varies from 50% to 90%, depending on the country.

Americans spend more on cosmetics than it would cost to provide basic education to the 2 billion people in the world who go without schools. Europeans spend more on ice cream than it would cost to provide basic water and sanitation services to those most desperately in need (UNDP 1998). The UNDP optimistically concludes that human development can be achieved by promoting “more equitable” economic growth and using participatory, democratic political methods. We agree. But we have a different conception of “eqitable” and “participatory democracy,” as this book will reveal.

## Criticisms of development measures

We should immediately note two kinds of deficiencies in the official data on both growth and development. First, not only do these data vary greatly in reliability from country to country but also characteristics such as production, income, or education are, in reality, culturally specific rather than universal. Yet, national and international agencies report only that which can be measured using “conventional” accounting procedures. Whose conventions are used? Those of the First World market economies. Thus, GDP measures that part of production sold for a price in a formal market—but not products consumed within the family nor services exchanged informally. Thus, a major portion of the economic activity in many Third World countries is either ignored completely or simply estimated. Much of this unreported product results from women’s work for example, 60–80% of the food is produced in the “informal sector,” and 70% of informal entrepreneurs are women.

All of this informal activity literally does not count when measuring the economy.