[Academic Script]

Characteristics of Developing Economics

Subject:	Business Economics
Course:	B. A. (Hons.), 6^{th} Semester, Undergraduate
Paper No. & Title:	Paper – 641 Elective Paper E2 Economic Growth and Policy
Unit No. & Title:	Unit – 1 Economic Development – Definitions and Concepts
Lecture No. & Title:	Lecture – 4 Characteristics of Developing Economics

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1. Introduction

After having obtained an idea about economic growth, economic development and of development economics as a separate branch of economics, we proceed to understand the characteristics of developing countries. Distinction can be drawn between developing and developed economies based upon these characteristics.

Objectives

1. Understand the characteristics of less developed economies.
2. Be able to draw a distinction between developing and developed countries based their characteristic features
3. Evaluate factors which are impediments to the process of economic development.
4. Be able to grasp how can we develop our own economy and society.
5. Understand how human development can be measured.

Characteristics of Less developed/developing economies:

1. High population burden: Developing countries are those which are passing through the second stage of demographic transition and hence face a phenomenon of population explosion. Population explosion is a phase of development when a country experiences very high birth rate (or very insignificantly falling birth rates) and declining death rate. As a result, the difference between birth rate and death rate is very high; population increase is actually the distance between birth rates and death rate. (The theory of demographic transition can be studied separately).

2. Low levels of national and per capita incomes and inequitable distribution of income: Low levels of national income means that a country has not produced more output. Lower national output means that a country has not productively employed its factors of production or utilized its resources efficiently.

On the other hand, lower income means the country has lesser amount of money to spend on infrastructure, health, education, utilities and ultimately lower social and economic welfare of the people.

Hence, countries with low levels of national income may be called developing economies.

However, level of national income is not a sufficient indicator of development.

- Some countries have relatively high amount of national income but their population is also very high which keeps the per capita income lower. One the other hand some countries have lower level of national income but the size of their population may also be smaller which keeps their per capita incomes higher.
- Some countries have high level of national income but are not able to utilize and manage it equitably leading to high amount of inequality, poverty and deprivation for a large segment of the population.

Hence, per capita income is considered a better indicator of development. A higher per capita income means that the average income per person is higher and therefore indicates greater production/availability of goods per person. However, per capita income is only a mathematical average and in reality some people might be receiving much higher income than this average while many others might be receiving much lower than this average.

For instance, if an income of Rs. 1,00,000 is divided among 1,000 persons, each gets an average of Rs. 100. But if the same income is divided among 2,000 persons, each one gets only Rs. 50.

Besides, an average income of Rs. 100 does not mean each persons gets Rs. 100. Some may get Rs. 500 in actual distribution, while some may get only Rs. 10 each.

Hence such unequal distribution indicates failure on part of the system to give equitable employment opportunities to all or to distribute the incomes in a fair manner.

3. Dependence on agriculture and slower pace of industrialization: These are countries which are highly dependent on agriculture for employment and generation of national income. A significantly large proportion of population is dependent on the primary sector.

Growth of the agricultural sector is generally relatively lower than that of the industrial sector as there are natural restrictions on output, variety of output and price elasticity of domestic demand and exports is lower.

(Even if price is reduced, demand cannot be raised beyond a certain level. Demand for food and agricultural goods are limited to necessary demand. Demand for commercial crops is relatively higher.)

Agricultural sector can develop better if technology and capital are cheap and easy to access. But, in such countries pace of industrialization and capital formation is lower and hence agricultural sector faces scarcity of physical and financial capital.

4. Resource scarcity: Countries which face scarcity of natural resources (like land, climate conducive for agriculture etc.), essential man made resources (electronic resources, food, tools and so on) and technology resources (e.g. internet facilities in present times) are not able to provide enough goods or skills to a large proportion of their population and hence the welfare of their people tends to be lower.

Resource scarcity may arise due to natural factors or high population burden.

For any country, resources prove to be scarce when growth rate of population is too high for the available resources to fulfil the basic needs of all people. If population growth rate is very high, production of basic good must keep pace in fulfilling demands, but production of goods depends upon availability of resources and productivities of factors of production. In other words, population growth rate must be in accordance with the country's capacity to produce goods or the country must enhance her capacity to produce goods to provide for the welfare of her rising population. Otherwise, population becomes a burden upon resources.

2. Slow pace of technological advancement

Some countries are not able to cope up with the pace of technological advancement. These are countries which are not able to easily develop their own technologies and have to buy technology from other countries. In order to buy technology from other countries, these countries need huge amounts of foreign exchange which they do not have. Prior to the economic reforms of the nineties, the developed world used to sell obsolete technology to the developing countries at very high rates. Hence developing countries used up most of their foreign exchange reserves in buying out dated technology and could not grow faster as technologies were outmoded.

Since the nineties, countries of the world have become more open to Foreign Direct investment and through FDI, developing countries get more updated technologies from the developed nations.

6. Low productivity of Factors: Countries which experience low productivity of factors of production usually struggle to produce enough goods to meet demands. Factor productivity can be evaluated in relation to the rising demands, in comparison with the productivity of similar factors in other countries or in relation of capacity utilization.

(Traditionally there are four factors of production – land, labour, capital and enterprise).

7. Mismanagement of resources: Some countries are not able to manage the allocation and distribution of available resources and goods among different sectors and segments of population owing to number of reasons like, lack of political will, corruption, civil unrest which leads to disruption in distribution process along with wastages, poor logistics, inefficient administration, inefficient governance, frequent occurrence of natural disasters (and poor disaster management machinery) which also disrupt the distribution process and also lead to wastages, and so on.

8. Low rate of capital formation: Low rate of capital formation results in lower development. Capital formation means cumulative increase in a country's stock of tangible assets over a period of time. A given stock of capital when used productively helps to build up more capital.

E.g. If mining is well developed in a country the production of steel will be efficient. Steel helps to create infrastructure and machinery which in turn help to boost production and trade. Production and trade help in generating more incomes. When a nation saves a proportion of the income and invests it productively, new capital is formed.

Low levels of savings and capital formation in relation to the population naturally mean lower welfare and therefore countries with lower rates of savings and capital formation are called developing countries.

9. Predominantly agrarian and unorganized structure of employment and slower pace of industrialization: Countries that are predominantly agrarian cannot grow faster. Demand for agricultural goods remains to some extent fixed. The demand for food grains remains fixed by the size of the population and thus demand driven growth is limited in the agricultural sector. Besides, the demand for cash crops can grow only when industrial sector and capital formation are high.

When industrial sector is smaller, more people are dependent on agricultural sector. When more than required people work on a fixed plot of land, the productivity of the extra persons becomes zero. In other words, there is disguised unemployment. But, all the so called employed people share the income generated from the fixed land and thus, the per capita income also reduces.

According to Ragnar Nurkse, the disguised labour should be shifted from agriculture to industry where their productivity can be raised. But, industrial sector can grow gradually with increase in efforts, productivity of factors, technological advancement, capital formation, education etc. Hence, in developing countries the shift from agricultural predominance to industrial predominance is slower.

Besides, when industrial sector is relatively smaller, greater proportion of urban employment takes place in the unorganized sector. Employment in the agricultural sector is generally unorganized. In the unorganized sector, wage structure is exploitative, job security does not exist and labour welfare is lesser.

Such structures result in high rates of unemployment and high amount of under employment.

10. Excessive rural-urban migration: Developing countries are also characterized by a large extent of rural-urban migration of people for jobs, comfortable life, for education, for exposure and experience of a professional world, for entertainment and so on.

Developing countries have lop-sided development of economic and social infrastructures and rural areas have highly inadequate facilities and opportunities.

3. Imbalanced Regional Development

These economies do not have enough resources to develop all the regions and sectors simultaneously. Hence, some sectors and regions are more developed than the others owing to biased investment patterns. For example, when a less developed nation attempts to industrialize, majority of her resources are spent in creating roads, ports, bridges, power generation stations etc. and most financial resources are directed to various businesses. As a result, the nation does not have enough resources to spend the agricultural sector and sometimes even on socio-economic infrastructures like health and education. Likewise, some states/cities may be more developed than the others.

12. Existence of Dual Economic Set-up: When the less developed nations make aggressive efforts towards development, some sections within one sector may become highly advanced while others within the same section suffer from backwardness. For example, In India till recent times we find that while banking sector in urban areas is highly modern, there people even in urban areas who do not even have a single bank account and there are villages which do not have bank branches at all. On our roads we find highly advanced automobiles and bullock carts plying together.

13. Structure of Foreign Trade: Developing countries have to import more goods while their capacity to export is relatively lower. In the initial years of development, these countries import more goods essential for survival of their populations like food. As they start industrializing they import more industrial goods and capital goods also called developmental imports like imports of machinery, raw materials, energy, technology etc. After the process of industrialization takes off, the maintenance imports tend to increase. Maintenance__imports are essential for maintaining the growth and pace of industrialization and constitute advanced/green technology imports, spare part imports and so on.

In the initial years of development, these countries are able to export only primary goods as they are not industrially well developed. The price elasticity and exchange rate elasticity of these goods is low and thus these countries cannot easily increase exports of such goods. Besides, owing to high population and lower productivities of factors these countries have lesser exportable surplus. As these countries start industrializing, the industrial and service sector exports tend to increase but it takes time to compete with the quality of industrial goods in the international market.

Hence, these countries usually have negative balance of trade, they have to borrow more on the capital account of their balance of payments and hence their debt burdens are high.

14. High magnitude of Poverty, higher inequality of income distribution, Low Levels of Literacy, Superstitions and Unscientific way of Living: Owing to lesser resources, low productivity of factors, high growth rate of population these countries have a higher propensity to consume for survival needs and have lower savings to create more capital, to increase literacy or to improve conditions of living.

15. Existence of vicious circle of low incomes, low productivity and unemployment:

Developing countries experience a vicious circle of lower development. These countries have a high growth of population.

High growth of population→lower employment→ higer dependence on agriculture →lower incomes→higher poverty→again lower incomes→illiteracy→mal nutrition→lower productivity→again lower employability→ corruption →further poverty→superstitions→lack of awareness→nurtures further growth of population→lower incomes for the government→lesser utilities→lower human development...

This way one negative characteristic nurtures more negative characteristics. Such a circle requires major reforms, push and policies to break. Once the circle is broken, the cycle of development begins.

Note: Countries move from lower level of development to higher level of development. They do not stay at the same level always. Governments, society and international organizations come together to help countries grow and develop. Hence in present times we do not use the term 'under developed' for any nation. All countries are developing in a way. Their pace and extent of development differs though.

4. Some measures of inequality and measures of human development

In the earlier lectures we studied that growth can be measured by quantitative parameters. We also studied the indicators of development. Let us now look at some measures of inequality and measures of human development.

I. Measures of Inequality:

1. Lorenz curve and Gini ratio:

Lorenz curve was given by American economist Max O. Lorenz in 1905 for measuring inequality of wealth. The Gini coefficient (sometimes termed as Gini ratio) was given by Italian statistician Corrado Gini in 1912.

Consider the following example:

Cumulative % of pop.	Perfect Distribution of Share in Cumulative Wealth	Unequal Share in Cumulative % of wealth
Bottom 20%	20%	2%
Second lowest 20%	20%	10%
Middle 20%	20%	20%
Second highest	20%	30%

20%		
Top 20%	20%	38%

A perfect distribution of national wealth/national income among all percentiles of households is an ideal situation. It is not a real distribution for any country in the world. In reality there always is some unequal distribution. The distribution may be less unequal for developed countries and highly unequal for developing countries. Lorenz curve and Gini ratio give this measure of inequality.

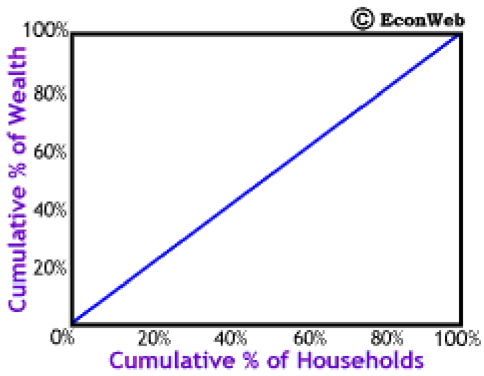

Figure 1: line of perfect equality

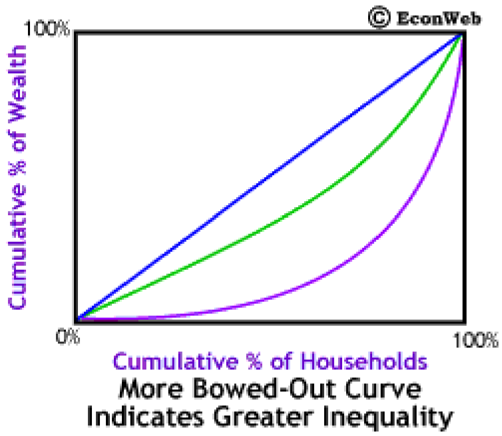

Figure 2: Lines of inequality

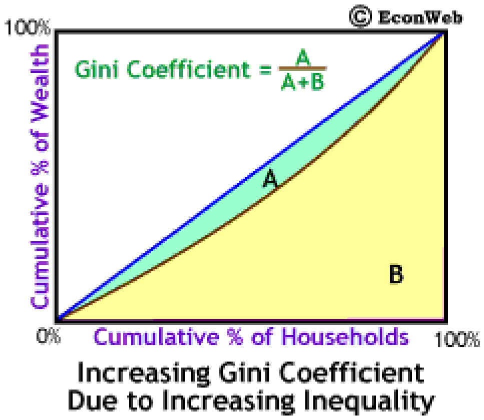

Figure 3: Representation of Gini Ratio

Source of figures: www.econweb.com/texts/current/Mansions/inequality-measure.html

The first figure shows line of perfect equality.

The second figure shows that bottom 20% of the population get an insignificant share in wealth/income while the upper percentiles of population receive a much higher share. As the line of inequality drifts farther from the line of equality, it represents greater inequality.

The Gini ratio is expressed in figure 3 and given as $\text{Gini C.} = \frac{A}{A+B}$

II. Measures of Human Development

1. PQLI-Physical Quality of Life Index:

Developed in the mid seventies by Morris David Morris, it is an index of well being of a nation represented by average life expectancy, infant mortality and literacy.

Step 1 Find out the worst ALE, IM and literacy for any country in the world.

Step 2 Put the worst performance as 0 and the best performance as 100.

Step 3 Find out each of these for a country. And place that value on the scale of 0 t o100.

Step 4 Work out average of the three scale values for a given country. Such average index is the PQLI for the country.

This measure is now replaced by other measures.

2. HDI-Human Development Index:

Developed by Mehbub ul Haq and A. K. Sen and introduced by UNDP (published for the first time in 1990 but calculated for previous years for various countries). It is an average index of life expectancy at birth, adult literacy rate and combined gross enrolment ratio for primary, secondary and higher education.

For each indicator, the index is calculated as,

$$\text{Index} = \frac{(\text{actual value} - \text{minimum})}{(\text{maximum} - \text{minimum})}$$

Minimum values for each of these are based on the worst performance found in the world for a particular year.

Any cuntry's actual performance is then taken as actual value.

The average index of all the three indices is worked out and placed between 0 and 1.

Low human development: HDI lower than 0.5.
Medium human development: HDI between 0.5 and 0.8.
High human development: HDI higher than 0.8.

3. HPI-1-Human Poverty Index for developing countries and HPI-2-Human Poverty Index for developed countries:

The HPI index developed by UN (introduced in 1997) uses indicators of long and healthy life, access to knowledge, and a decent standard of living (access to clean drinking water and

underweigh children upto the age of 5). (social exclusion was added later).
It is calculated in the same way as HDI.

4. MPI-Multidimensional Poverty Index:
Published for the first time in 2010 in the Human Development Report. The MPI was created by using a technique developed by Sabina Alkire and James Foster. It is a measure of poverty designed to capture the multiple deprivations that each poor person faces at the same time with respect to education, health and other aspects of living standards. The MPI reflects both the incidence of multidimensional poverty (the proportion of people in a population who are multi-dimensionally poor), and its intensity (the average number of deprivations each poor person experiences at the same time).

5. GDI-Gender related Develoment Index:
It was introduced for the first time in the Human Development Report of 1995. It is a gender sensitive calculation of HDI.
It uses an "inequality aversion" penalty, which creates a development score penalty for gender gaps in any of the categories of the Human Development Index (life expectancy, adult literacy, school enrolment, and logarithmic transformations of per-capita income).

6. GEM-Gender Empowerment Index:
This was also introduced by UNDP in the Human Development Report in 1995. It is measured using relative economic incomes of women, participation of women in high-paying positions with

economic power, and access to professional and parliamentary positions.

5. Summary

In this lecture we understood the characteristics of developing countries. The difference between developing and developed nations is drawn on the basis of these characteristics. Some of these characteristics are very similar in most developing countries irrespective of the region they fall under. Low production, low incomes, high population, scarcity of capital and high dependence on primary sector, wastage of resources and mismanagement of resources nurture many other aspects which are unfavourable to the growth process. Thus, these countries experience a vicious circle of counteractive tendencies which lessen the pace of development. It requires strong will and effort on part of all national institutions and machinery to break such circles and move towards prosperity.

We further saw the use of Lorenz curve and Gini ratio as measures of income inequality and noted some measures of human development. Though it is difficult to measure human development, experts have given some measures and the Human Development Report uses some of these measures.