Essay # 1. Meaning of Economic Development (Traditional View):

No distinction was drawn between economic growth and development in the beginning of the evolution of economics of development. However, since the seventies it has been thought necessary to distinguish between economic growth and economic development. There are two views even about the concept of economic development. The traditional view has been to interpret it in terms of planned changes in the structure of national product and the occupational pattern of labour force and also the institutional and technological changes that bring about such changes or accompany such changes.

It may be noted that Kuznets in his study of Modern Eco-nomic Growth interpreted the process of modern economic growth which involves these structural changes. In this view during the process of economic growth share of agriculture in both national product and employment of labour force declines and that of industries and services increases. Vari-ous strategies of development which were suggested until 'seventies' generally focused on rapid industrialization so that structural transformation could be achieved.

For this purpose appropriate institutional and technological changes were recommended to bring about such structural changes. Thus C.P. Kindleberger writes, Economic growth means more output and economic development implies both more output and changes in the technical and institutional arrangements by which it is produced.

Thus, according to traditional view, economic development implies growth plus structural change. Structural change refers to changes in technological and institutional factors which cause shift of labour from agriculture to modern manufacturing and services sectors and also generate self-sustaining growth of output. An aspect of structural change which is of special mention is that during the process of economic development there occurs a shift of working population from low productivity employment in agriculture to the modern industrial and services sectors having higher levels of productivity of labour.

That is, during the process of economic development percentage share of working population in agriculture sharply falls whereas percentage shares of working population employed in modern industrial and services sectors substantially increase. Along with this change in sectoral distribution of labour force there occurs a change in sectoral composition of national in-come in which percentage contribution of agriculture to national income and declines and percentage contributions to national income of industrial and services sectors increase. This occurs due to the change in pattern of consumption of the people as economy grows and people's income increases as well as due to the changes in levels of productivity in the different sectors of the economy.

It is worth mentioning that in this view causal references were made to the role of some social factors such as growth of literacy, education and good health in economic development but they were considered to be of secondary importance. On the whole, in this view of economic development which generally prevailed till seventies, development was considered to be an economic phenomenon in which benefits from growth in overall GNP or per capita GNP and the structural changes accompa-nying it would trickle down to the poor and unemployed. No separate or special attention was paid to eliminate mass poverty and unemployment and to reduce inequalities in income distribution.

Essay # 2. The Concept of Economic Development (Modern View):

The experience of the developing countries during the sixties and seventies showed that whereas target rates of economic growth were in fact achieved trickle-down effect in the form of creation of more employment opportunities, rise in wages and improvement in income distribution did not operate. The problems of poverty, unemployment and income inequality further worsened instead of getting reduced during the process of growth in the nineteen fifties and sixties in the developing countries.

For instance, in India, Dandekar and Rath found that 40 per cent of rural population in India lived below the poverty line in 1968-69. Using somewhat different approach, B.S. Minhas estimated that 37 per cent of rural population in India lived below the poverty line in 1967-68. Similarly, the magnitude of poverty and unemployment and the extent of income inequalities also increased in many other developing countries.

Thus, due to the failure of traditional strategies of development in solving the problems of poverty, unemployment and inequality, it was realised in the seventies that the concept of development should be broadened so that it should signify that well-being of the people has increased. This led to the view that economic development should not be judged on the basis of growth in GNP alone. Therefore, when we regard the well-being of the masses as the ultimate objective of development, we have to see whether poverty and unemployment are decreasing and how the increases in gross national product or national income are being distributed among the population.

Economic devel-opment will take place in true terms only if the poor people are raised above the poverty line. Late Prof. Sukhamoy Chakravarty rightly writes, "The rate of growth strategy is by itself an inadequate device to deal with the problems of generating employment opportunities and for reducing economic disparities. Much depends on the composition of the growth process and how growth is financed and how benefits from growth process are distributed,"

It is worth mentioning that there is no guarantee that when there is increase in GNP, employment will also increase. It can happen that with the use of more capital-intensive technique while produc-tion may be increasing at a rapid rate, employment may be falling instead of rising.

According to the modern perception of economic development, rapid increase in GNP secured through displacing labour by machines and thus causing rise in unemployment and underemployment cannot be called true economic development.

Professor Dudley Seers makes the meaning of economic development according to the new perception in the following words-"The questions to ask about a country's development are therefore- What has been happening to poverty? What has been happening to unemployment? What has been happening to inequality? If all three of these have declined from high levels, then beyond doubt this has been a period of development for the country concerned. If one or two of these central problems have been growing worse, especially if all three have, it would be strange to call the result development even if per capita income doubled. "

Recently, the concept of economic development has been further widened so that it now in-volves not only reduction in poverty, inequality and unemployment but also requires improvement in quality of life which includes cleaner environment, better education, good health and nutrition. Thus World Development Report 1991, published by the World Bank, asserts- "The challenge of develop-ment is to improve the quality of life, especially in the world's poor countries, a better quality of life generally calls for higher incomes but it involves much more. It encompasses as ends in themselves better education, higher standards of health and nutrition, less poverty, a cleaner environment, more equality of opportunity."

Thus the concept of economic development has been greatly broadened. Today economic development is interpreted as not only in more growth in Gross Domestic Product (GDP) but also in terms of good quality of life which, according to Prof. Amartya Sen,'consists in enlargement of opportunities for people and freedom of human choices'.

This new concept of devel-opment includes achievement of freedom from servitude to ignorance and illiteracy. It also includes enjoyment of human rights. Thus United Nations 'Human Development Report' of 1994 in the writing of which Prof. Amartya Sen made a significant contribution, asserts, "Human beings are born with certain potential capabilities. The purpose of development is to create an environment in which all people can expand their capabilities, and opportunities can be enlarged for both present and future generations. Wealth is important for human life, but to concentrate on it exclusively is wrong for two reasons. First, accumulating wealth is not necessary for the fulfillment of some important human choices. Second, human choices extend far beyond economic well-being."

On the basis of various ingredients of good quality of life and other criteria such as enlargement of human choices and freedom a human development index is prepared by United Nations Development Programme (UNDP). This human development index is considered as a better indicator of economic development index.

Essay # 3. The Objectives of Economic Development:

From the study of Sen's capability approach to development and Goulet's core values of development we are in a position to explain the objectives of development. The basic objective of development is broad-based improvement in the economic and social conditions of our people so as to achieve better quality of life for them.

Important Objectives of Development:

1. To Achieve a Higher Rate of GDP Growth:
The first and foremost objective of development is to achieve a higher rate of GDP growth so as to raise the living standards of our people. Rapid growth of total GDP or per capita income is considered necessary because it ensures an expansion in the productive capacity of the economy without which broad based improvement in living standards of the people is not possible. However, it should be recognized that faster economic growth, though necessary, is not a sufficient condition for raising the living standards of our teeming millions. This is because one can easily imagine a growth process which may not be sufficiently inclusive to ensure a spread of benefits to the mass of our population.

There are three reasons why GDP growth is necessary for raising the living standards of the population. First, rapid growth of GDP ensures a higher expansion in total income and production which, if growth process is sufficiently inclusive, will make available a larger output of goods and services to be consumed by the people and thus raise their living standards.

Secondly, rapid economic growth generates more employment opportunities and income enhancing activities of the people, provided labour-saving technologies are not used for production of goods both in the industrial and agricultural sectors.

Third, higher GDP growth is important because it generates higher revenues for government which help to finance anti-poverty programmes started by the government.

2. To Eradicate Poverty and Unemployment:
The second important objective of development is to eradicate poverty. In Amartya Sen's approach to development, poverty should be viewed as deprivation of basic capabilities rather than merely as low income. The existence of poverty or deprivation of basic capabilities is reflected in hunger, significant undernourishment/ especially of children premature mortality, permanent morbidity, widespread illness, and lack of basic education and other failures. Though economic growth is necessary for elimination of poverty but is not a sufficient condition for it because it is related to income distribution in a society as well.

Related to issue of poverty is the question of unemployment which exists on a large scale in developing countries, especially in labour-surplus countries such as ours. Chronic and long-term unemployment exists in the developing economies because due to higher population growth relative to capital formation it has not been possible to absorb the increasing number of workers in productive employment resulting in large-scale unemployment in developing countries.

Gainful employment is the means of livelihood for the masses of the population. The growth of employment opportunities needs to be accelerated both in manufacturing and services sectors to provide employment to increasingly educated population which has high expectations and aspirations.

Unemployment leads to the feelings of worthlessness and frustration among the youth leading to the increase in incidence of crime in the society.

3. To Expand The Freedoms Enjoyed by The People:
The other important objective of development, as has been explained in Amartya Sen's approach to development and Goulet's core values, is to expand the freedoms that people of a society enjoy. Growth of GDP or of individual incomes or industrialization or technological progress are merely means to expanding human freedoms but freedoms depend on other factors as well. As Sen Stresses viewing development as expansion of substantive freedoms directs attention to end or objective of development rather than means such as GDP growth or industrialization which play an important role in the process of development.

If the objective of expansion of freedoms is to be achieved, the various sources of unfreedom such as lack of public facilities of education and healthcare, denial of political liberty and basic civil rights (such as liberty to participate in public discussion) and denial of equal rights to women in the society have to be removed. It is worth mentioning here that some have supported the denial of political liberty and basic civil rights to the people on the ground that they promote economic growth.

However, Amartya Sen has rightly pointed out that there is little evidence that authoritarian politics actually helps economic growth. Indeed, empirical evidence very strongly suggests that economic growth is more a matter of friendly economic climate than of a harsher political system.

Essay # 4. Evolution of Economic Development:

The study of development economics as a separate discipline is relatively new as about 65 years ago in 1950s the study of the problem of economic development of poor developing countries did not constitute an important distinct branch of economics. This is despite the fact that classical economists such as Adam Smith, Ricardo, Malthus, and Marx extensively dealt with the study of development of the economies. However, with the appearance of neoclassical economics propounded among others by Alfred Marshall and A.C. Pigou who were mainly concerned with explaining efficient allocation of resources in a free market economy, development economics dealing with the developing economies found no place in their works.

Believing in Say's law of markets they assumed that full employment of resources would prevail in the economy and further that the working of price mechanism would ensure sufficient incentives to save and invest to bring about appropriate growth of GNP. It was generally believed that neoclassical economics applied to developed and developing countries alike. Therefore the need for a special theory to explain economic growth and development for developing countries was not felt. In the 1930s and 1940s, the economists led by J.M. Keynes remained occupied with the problem of involuntary unemployment and depression as severe depression causing huge unemployment took place in 1929-33 in the industrialized countries.

The renewed interest and public concern with the development of poor countries began only after the Second World War when the poverty of the underdeveloped countries of Asia, Africa and Latin America posed a great challenge to the peace and progress of the world as a whole and also many underdeveloped countries got freedom from the colonial rule.

It was felt that Keynesian economics which was concerned with the short-run problem of depression caused by fall in aggregate effective demand did not apply to the underdeveloped economies which faced a long-run and chronic problem of unemployment and mass poverty due to deficiency of cooperating factors (such as capital) and low productivity of resources. It was therefore felt that there was need for a distinct and separate branch of special economic theory which explains perpetuation of underdevelopment and general poverty and also the adoption of appropriate development strategies to initiate and accelerate economic growth in the developing countries.

It was pointed out that the problems of poverty, underemployment of underdeveloped economies were quite different and required special analysis. Therefore, development economics which is concerned with the economic growth, capital accumulation and underemployment in the developing countries became a special and distinct discipline. During 1950s and 1960s development policies in underdeveloped countries required acceleration of economic growth and eradication of poverty and chronic underemployment.

For this, economists laid stress on capital accumulation, mobilization of surplus labour for growth and industrialization based on import-substitution through economic planning and with active role of the government. It was thought that due to market failures, development through free market, as emphasized by neoclassical economics, would neither achieve efficient allocation of scarce resources nor brings about desired GDP growth rate to remove poverty and employment. Since rate of domestic saving in these underdeveloped countries was inadequate to bring about a desired rate of growth, the need for foreign aid to supplement domestic saving was emphasized in early approaches to development based on application of Harrod-Domar growth model.

Furthermore, it was suggested in the early approaches to development in the 1950s and 1960s that since demand for primary products was inelastic by advanced industrialized countries, as explained by Prebisch, Singer and Myrdal, to accelerate growth through expansion of primary exports by developing countries would cause deterioration of terms of trade. This led to export pessimism, that is, little prospects of acceleration of growth through promotion of exports. Therefore, those economists who laid stress on limitations of development based on expansion of primary exports, advocated for import-substituting industrialization to promote economic growth and solve the problems of poverty and unemployment in developing countries.

Much of the thinking about development in this early period was how to break out of poverty trap or vicious circle of poverty or 'low level equilibrium trap'. For this purpose Ragnar Nurkse put forward a balanced 'growth strategy' in which he suggested undertaking of simultaneous investment in a wide range of industries so that the workers employed in different industries could generate demand for each other's products so as to ensure balanced growth by overcoming the problem of demand deficiency.

Hirschmanm, on the other hand, laid stress on the scarcity of decision-making enterprise and also emphasized forward and backward linkages of different industries and to take advantage of them he proposed 'unbalanced growth strategy' by concentrating investment in a few industries of strategic importance from the viewpoint of economic growth. Leibenstein and Nelson considered rapid population growth as a retarding factor of economic growth and recommended a certain 'critical minimum effort' in terms of investment so as to break out the low level equilibrium trap.

Besides, Arthur Lewis proposed a model of growth of a dual economy with surplus labour in which he emphasized industrialization of underdeveloped countries by mobilizing disguisedly unemployed labour in agriculture or subsistence sector and ploughing back of profits so earned for further capital accumulation and industrial growth. In India Mahalanobis growth model on which Second Five Year and Third Five Year Plans were based gave a high priority to basic heavy industries producing fixed capital goods (i.e., machines) and basic intermediate goods such as steel, fertilizers and emphasised impor-substituting industrialisation to accelerate rate of growth of the Indian economy.

Harrod-Domar model of growth based on Keynesian framework which dealt with the problem of steady growth was applied to the growth problem of developing countries. Harrod-Domar model suggested that growth depends on the rate of saving and capital-output ratio, ($g=s/v$), where s represent ratio of saving to national income and v is rate of growth of GDP).

Unlike the neoclassical economics which assumes smoothly working market mechanism, the early development economists adopted a more structural approach to development. They emphasise rigidities, lags, shortages and surpluses and low elasticities of demand and supply in developing countries. Prebisch and Singer have been prominent economists who laid stress on the limitations of development based on expansion of primary exports because of the adverse effects on terms of trade.

In the early 1970s there was realisation by economists that growth in terms of GDP, though a necessary condition is not a sufficient condition for the reduction of poverty, inequality and unemployment. Therefore, in the second phase of the evolution of development economics when the emphasis on growth of GNP was downgraded, the focus of analysis shifted directly to the removal of poverty, unemployment and inequality in the developing countries.

Mahboob ul Haq, an eminent economist of World Bank who along with Amartya Sen was pioneer in the development of the concept of Human Development Economics Index (HDI) wrote, "The problem of development must be defined as a selective attack on the worst forms of poverty. Development goals must be defined in terms of progressive reduction and eventual elimination of malnutrition, disease, illiteracy, squalor, unemployment and inequalities. We were taught to take care of our GNP because it would take care of poverty. Let us reverse this and take care of poverty because it will take care of the GNP. In other words, let us worry about the content of GNP even more than its rate of increase ".

Thus in the seventies, the reliance on GDP growth alone to solve the problems of poverty and unemployment was challenged. It was pointed out by several economists that benefits of growth were not trickling down to the poor and the number of people living below the poverty line had increased in developing countries. Even the meaning of economic development was questioned. It was suggested that economic development was not the same thing as economic growth.

According to the new view, economic development means not only the increase in GNP (or GNP per capita) bat also the reduction in poverty, unemployment and inequalities of incomes. A World Bank study titled 'Redistribution with Growth laid stress on redistribution of incomes with reduction of poverty along with GDP growth for development to be meaningful. Besides, in the 1970s and 1980s ILO emphasised that for true development to take place basic human needs must be fulfilled. These basic human needs are food, clothing, shelter, healthcare and availability of drinking water. According to this, without these basic needs being met, development cannot be said to have taken place.

Another important change in the approach to development during 1970s and 1980s was a shift in the emphasis from industrialisation to agriculture. It was proposed that agriculture-led growth strategy would ensure higher growth rate, larger amount of employment generation without causing inflation. Further, during 1970s and 1980s role of human capital (i.e., education and health) instead of physical capital began to be emphasised for boosting economic development.

Besides, in view of the low labour intensity of technologies imported from abroad, the need for development of appropriate technologies suited to the factor endowments of developing countries was highlighted. In this connection, it was pointed out that a developing country should not blindly import foreign capital- intensive technologies but should use discretion as to what technology could or should be imported.

The most significant change in the thinking of development economists came during the decade of 1980s, especially in the mid-eighties. This change was resurgence of neoclassical economics which gives important role to private sector and market mechanism in the process of development.

It was felt that centralised planning and excess regulation and control over the private sector by the State and higher importance given to the public sector was obstructing growth due to its inefficiency in the use of resources. Besides, under the controlled regime, the twin crises of high fiscal deficit and external balance of payments crisis made the growth unsustainable. The policy framework of neoclassical economics such as liberalisation, privatisation and globalisation was suggested by prominent economists, I.M.D. Little, Jagdish Bhagwati, Bela Balarsa who were the advisors to the World Bank and IMF argued that free markets and greater role of private sector (including foreign investors) would ensure efficiency by encouraging competition.

Thus the advocates of the adoption of policy framework of neoclassical economics emphasised government failures to obstruct rapid development. Similar to the neoclassical economists' approach to development Dr. Manmohan Singh who initiated economic reforms in India in 1991 in his first budget speech as Finance Minister on July 24, 1991, said, "Over-centralisation and excessive bureaucratisation of economic process have proved to be counterproductive. We need to expand the scope and the area of operations of market forces. A reformed price system can be a superior instrument of resource allocation and qualitative control".

Further, advocating for the adoption of export orientation of development strategy instead of import-substituting industrialisation can be redefined as "the vision of self-reliant economy as one which can meet all its requirements through exports without undue dependence on artificial external sops such as foreign aid."

As a step towards economic reforms the neoclassical economics recommended the removal of price distortion introduced by government controls and getting all prices right to achieve efficient resource allocation. As Gerald Meier writes, "Markets, prices and incentives became central. Inward- looking strategies of development were to give way to liberalisation of foreign trade regime and export promotion. Inflation was to submit to stabilisation programmes. State-owned enterprises were to be privatised. A poor country was now considered poor because of inappropriate policies, and good economics, that is, neoclassical economics – was good for the developing country".

Development Economics as a Separate Discipline:

In the 1950s and 1960s the pioneers in development economics had asked why underdeveloped countries were poor and backward and put forward the grand theories and development strategies for starting and accelerating economic growth so as to lift them out of poverty trap. In propounding the various theories and strategies to accelerate economic growth in developing countries, the pioneers in development economics abandoned the use of neoclassical economies which involves free working of market mechanism and role of material incentives and profit motive guiding allocation of resources and economic growth in an economy.

The pioneers in development economics considered the neoclassical economics as a special case applicable to developed countries having not much relevance for the underdeveloped countries as the latter are structurally different from the developed economics. These pioneers investigated the factors that perpetuate underdevelopment and poverty in underdeveloped countries and for initiating and boosting economic growth not only rejected the principles of neoclassical economics but also found theories of development of classical economists such as Adam Smith, Ricardo, Malthus and Marx not fully applicable to the present-day developing economies. Prominent contributors to development economics are Arthur Lewis, Ragnar Nurkse, Albert Hirshman, Hans Singer, Rostow, Michael Todaro, Amartya Sen among many others.

However, as explained above, from the early eighties there has been greater reliance on neoclassical economics which gives greater role to market mechanism and profit motive for efficient resource allocation and economic growth in developing countries. Further, as this neoclassical economics applies equally to rich developed countries and poor developing countries.

Therefore, it has been asserted by some economists prominent among whom is Albert Hirshman, that the development economics which was thought to be a separate and distinct subject, different from the principles of neoclassical economics has collapsed and that there is no any distinct or special subject of development economics applicable to developing countries alone.

To quote Hirshman, "The sub-discipline of development economics has achieved its considerable lustre and excitement through the implicit idea that it could slay the dragon of backwardness virtually by itself or at least that its contribution to this task was central. We know that this is not so."

Hirschman's view has been challenged by Prof. Amartya Sen. According to him, the original themes with which development economics has been concerned "while severely incomplete in coverage did not point entirely in the wrong direction and the discipline of development economics does have a central role to play in the field of economic growth in developing countries".

Hirschman pointed to the main themes or ideas which formed the basis of development economics.

They are:

(1) Rural underemployment including disguised unemployment that prevailed in underdeveloped countries which became the focus utilisation of surplus labour for industrial growth or capital accumulation;

(2) The subject of late industrialisation of underdeveloped countries which, according to the standard development economics required active role and guided efforts by the State and also economic planning and protection measures by the state to overcome the disadvantages of late industrialisation.

While there have been differences about certain issues in development strategies to be adopted to break out of the low-level equilibrium trap but, as has been mentioned by Amartya Sen, the following three are the strategic themes in terms of economic policy with which standard development economics has been concerned to achieve rapid economic growth:

1. Industrialisation.

2. Capital accumulation.

3. Mobilisation of underemployed or disguisedly unemployed labour for bringing about economic growth.

4. Planning in an economically active State.

As explained by Amartya Sen, the above themes used for planning and active role of the State in promoting industrialisation (or capital accumulation) and the use of surplus labour for it are parts of the standard development economics on account of which neoclassical economics has been said to be inapplicable for acceleration of economic growth in developing countries.

Hirschman who explained the rise and decline of development economics hold the view that the neoclassical economics as applicable to both developed and developing countries alike. In other words, he talked of the relevance of 'mono-economics' for both developed and developing countries and argued against the development economics as a separate and distinct subject.

The resurgence of neoclassical economics has drawn its support from the high growth performance of East Asian countries such as South Korea, Taiwan, Hong-Kong and Singapore in which higher economic growth rates have been achieved based on market mechanism, private enterprise, profit motive and material incentives, and liberal foreign trade.

On the other hand, the lower growth in developing countries of South East Asia, Africa and Latin America has been cited as a result of the intervention in market by the government and role of planning in resource allocation in the growth process. Similarly, failure of development experience in Soviet Russia and China under activist state and centralised planning played a significant role has been cited as a proof of collapse of standard development economics with its emphasis on role of State and economic planning.

The sum and substance of the critique of development economics has been that neoclassical economics with its role of free market mechanism, private enterprise, material incentives ensure higher economic growth as against State-guided industrialisation through centralised planning.

However, the above mentioned defence of neoclassical economics and critique of development economics has been challenged, among others, by Amartya Sen. To quote Sen, "I believe that contentious and simplistic though development economics might have been in some respects, the main themes that were associated with the origin of development economics and have given its distinctive character are not rejectable for that reason".

It is worth mentioning that traditional development economics has concentrated on economic growth as against economic development which is a broader concept than economic growth.

However, so far as economic growth is concerned, the strategic themes such as role of capital accumulation, industrialisation and role of State and planning for acceleration of economic growth is concerned Amartya Sen using World Bank data of GNP per capita, gross domestic investment, (i.e., capital formation) as per cent of GDP and percentage share of industry in GDP and growth rate during 1960-80 pertaining to 14 low-income countries and 18 middle income countries has shown that capital accumulation and industrialisation have played an important role in achieving higher GDP growth rate.

As regards role of mobilisation of surplus labour he points out that high growth performance has distinguished record of labour-using growth particularly in case of China and South Korea mobilisation of labour for bringing about rapid growth is quite outstanding.

Lastly, he points out that in China, Romania, Yugoslavia and South Korea State intervention and planning have played a significant role in fostering economic growth. Thus, in conclusion, Sen writes- "Despite these average achievements the performance of various countries is highly different. There is still much relevance in the broad policy themes which traditional development economics has emphasized."

Further, in defence of traditional development economics, he writes – "The general policy prescription and strategies in this tradition have to be judged in terms of the climate of opinion and overall factual situation prevailing at the same time these theories were formulated". Development economics was born at a time when government involvement in deliberately fostering economic growth in general and in industrialisation in particular, was very rare, and when the typical rates of capital accumulation were very low.

It may be further noted that despite the revival of importance of neoclassical economics which emphasises liberalisation and privatisation for accelerating economic growth, role of State or Government is still in two important respects:

First, the Government has to play a significant role in making arrangements for the expansion of education, healthcare for the advance of human capabilities on which growth depends.

Secondly, the government has an important role in building up physical infrastructure such as power, roads, railways, ports and telecommunication as lack of these facilities is holding back economic development.

Thirdly, the Government has a special role in starting schemes for alleviation of poverty and unemployment in the developing countries as the free working of market mechanism will not ensure this.

Essay # 5. Obstacles to Economic Development:
1. Lack of Infrastructure:

Economic growth in the developing countries has been impeded by inadequate availability of infrastructure. Infrastructure includes power, irrigation, transport and communication. It may also include credit facilities available from banks and other financial institutions and also the facilities for the education and training of labour.

The availability of these infrastructures facilitates production in industry, agriculture and other productive sectors of the economy. These infrastructures give rise to external economies and thereby cause reduction in costs, facilitate production and increase efficiency in all productive sectors of the economy. Thus power (electricity) is used in the production process these days both in industry and agriculture.

It is now too well known in India that non-availability of adequate amount of power lowers industrial and agricultural development. Likewise, the existence of the means of transport is essential for transportation of raw materials to the place of production and to sell the goods produced too far off places. In fact, the availability of transport widens the market for goods and thereby encourages their production. Likewise, the availability of adequate irrigation facilities is necessary to raise agricultural output.

One of the most important hurdles in the growth of investment in developing countries is the acute lack of external economies which, as has been stated above, are provided by basic infrastructures such as transport, communication and power. In a developed country the economic system being highly diversified there are tremendous amounts of external economies which a new enterprise can draw upon. The various types of infrastructure in developed countries were generally built up by private enterprise although with the liberal help of the Government in the form of grants and loans.

In contrast, the contemporary developing countries lack an adequate system of transport, communication and power. For instance, the inadequacy of railway network in most of the newly independent countries of Africa and Latin America is a bottleneck in the expansion of national market and growth of industries.

Since development of power, transport, communication involves lumpy investment, has long gestation period and the returns accrue mainly in the form of external economies, the private enterprise is not attracted to build this infrastructure. The Government should therefore play an important role in undertaking the task of building up adequate infrastructure to speed up economic growth.

Likewise, there is a lack of adequate credit facilities or funds. For an entrepreneur who wishes to undertake business or set up some factory he should have sufficient funds to finance it. Credit facilities are also badly needed by farmers for agriculture. The growth of agriculture suffers if adequate credit facilities are not available. Therefore, the Government in the developing countries should give high priority to develop the facilities of providing adequate credit and finance for the development of industry and agriculture.

2. Demonstration Effect and Economic Growth:

In raising rate of capital formation, the developing countries have to contend against one problem which arises from demonstration effect on consumption. Demonstration effect leads to initiation and imitation of superior consumption standards stimulates consumption among the middle and upper middle class which increases their propensity to consume and consequently reduce their capacity to save.

Nurkse laid great stress on this new theory of consumption and saving. We ordinarily think that a man's consumption depends on his income. But that is not quite correct. A person's consumption does not merely depend on his own income but also on the incomes and therefore the consumption behaviour of his friends and relations with whom he maintains social contacts.

A man finds some of his friends using colour televisions, luxury cars, costly mobiles, refrigerators, air-conditioners, electric hot plates, and electric washing machines and so on and experiences a sort of restlessness and a craving is generated in his mind to enjoy these amenities some immediately and others some later days. These desires for conspicuous consumption generally outrun the consumer's means. Thus consumption behaviour of individuals depends not on absolute real income but on relative levels of real incomes. It does not depend on what we can afford but what the others afford and enjoy. This is what Duesenberry calls 'demonstration effect'.

The intensity of this demonstration effect on saving seriously impairs a person's capacity to save. He may save less even if his income has gone up; the ability to save may have increased but the willingness to save has decreased. It has been estimated that 75 per cent of the Americans do not save. The reason is not that they are too poor to save but that they are adopting better ways of living seen among the upper classes. It is thus the interdependence of consumer's preferences which determines the choice between consumption and saving. This is Duesenberry's relative theory of consumption and saving.

What is true of individual applies also to nations. The disparities in the real incomes of nations have a profound effect on the economic development of nations. Whereas the rich nations can help the poor nations develop economically and break the vicious circle of poverty, they also pass on to them their consumption patterns. The poor countries may not find it easy to increase productivity and raise income but it is easy to imitate costly consumption standards. Thus, there is international demonstration effect which lowers the propensity to save of the less well-off developing countries.

The demonstration effect aggravates propensity to consume and reduces capacity to save which is a serious impediment to economic development. The relative aspect of the problem needs to be emphasized again. It is not the absolute level of income which determines consumption pattern but the relative levels of national income of connected countries which affect consumption of a less prosperous country.

It follows therefore that even if the national income of a developing country goes up, it may not be able to save more than before simply because the income gap between this country and the other countries with which it has commercial or political intercourse has increased. The ability to save may have gone up but the willingness to save would have gone down on account of a keen desire to consume luxury goods which are consumed in the richer countries.

Thus, the interpersonal and international consumption functions are interrelated and not independent. The consumption and saving habits of the economically backward countries are greatly influenced by those of the prosperous countries. As Nurkse puts it, "When people come into contact with superior goods or superior patterns of consumption, with new articles or new ways of meeting old wants, they are apt to feel after a while a certain restlessness and dissatisfaction. Their knowledge is extended, their imagination stimulated, new desires are aroused, the propensity to consume is shifted upward."

It is not merely the superior consumption prevalent in rich countries which exercises influence on the consumption in the poor countries but also the knowledge of it. First, we know and then we imitate. Knowledge opens eyes to the future possibilities. "It widens the horizons of imagination and desires." New products or new patterns or designs of old products are constantly being advertised and brought irresistibly to the notice of the consumer at home and abroad. These new goods enter into the standard of living of the poorer communities. "The presence or the mere knowledge of new goods and new methods of consumption tends to raise the general propensity to consume."

The movies, the radio and television, spread of education and modern travel facilities are the powerful media through which new goods or new and better ways of living are communicated far and wide. In the present state of the world attraction of advanced living standards have a fairly wide influence on the consumption of the people of low-income countries.

Propensity to save is directly influenced by propensity to consume. When the poor countries copy living standards from the rich, they must pay the price. The price is that their capacity to save must diminish. This no doubt adds to the difficulties of bringing about economic development. We have already said that this saving potential can be mobilised only if consumption is kept at the same level as before. But we have seen that when such a country comes in contact with a rich country, its propensity to consume is likely to go up. The potential domestic sources of capital are seriously impaired by the impatience and dissatisfaction, which the demonstration effect tends to generate.

This impatience to raise living standards curtails the capacity to save. The conflict between the need to save and the desire to consume is intensified by the demonstration effect. Thus the small rate of saving in poor developing countries may not be altogether due to low level of real income. It may also be due to allurement of superior levels of living. This throws new light on international economic relations. Prosperity in one country may breed prosperity in another but it may also create difficulties by provoking consumption that it cannot afford and which it should avoid for some time at any rate. The high consumption of a rich country in this manner hinders capital formation in developing economies.

We may conclude in Nurkse's words – "The great and growing gaps between the income levels and therefore living standards of different countries, combined with increasing awareness of these gaps, may tend to push up the general propensity to save". The entrepreneurial class in India is, in fact, aping western modes of living and squandering away profits which they should plough back into investment. The country is poorer for this senseless consumption behaviour.

How to Overcome Demonstration Effect:

Curtailing the Consumption of Luxury Goods:

The working of demonstration effect in developing economies implies that wants should be regulated or curtailed. If wants of the people go on multiplying under the influence of demonstration effect, the demand for luxuries or non-basic consumption goods will increase. This will raise the propensity to consume of the economy resulting in a low ratio of saving to income. Further, the increased wants for luxuries and their consumption will divert the basic resources such as steel, cement, machines etc., towards their production.

As a result, the production of basic consumption goods will be starved of essential resources'. The use of scarce national resources to satisfy the non-basic wants of the people when millions who live below poverty line are unable to meet their basic wants for subsistence is purely a wastage of resources.

Thus, according to Prof. A. K. Dass Gupta, "The implication of luxury consumption for an underdeveloped country is more obvious and direct. The underdeveloped countries will need a high rate of growth for quite some time to come. Their level of per capita income is too low. In India, for example, the per capita income is hardly adequate to afford a man his minimum subsistence. Even with a stationary population, the country will thus require years of capital accumulation for it to attain a civilized standard. Luxury consumption slows down the rate of accumulation and thus hampers growth."

Limitation of Wants:

Mahatma Gandhi had warned long ago against multiplication of wants. He thus stated, "I do not believe that multiplication of wants is taking the world a single step nearer its goal. I whole-heartedly detest this and desire to increase animal appetites and go to the ends of the earth to satisfy them. If modern civilization stands for all this and I have understood it does, I call it satanic."

It may be noted that Mahatma Gandhi was not against the satisfaction of wants for consumption goods which are absolutely needed for maintenance of health and promotion of productivity. It is the multiplication of wants for non-basic consumption goods, that is, luxuries against which Mahatma Gandhi wrote. According to him, there is no end to the multiplication of wants and efforts ought to be made to reduce them. To quote him again, The mind is a restless bird, the more it gets, the more it wants and still remains unsatisfied. Therefore, the ideal of creating an unlimited number of wants and satisfying them seems to be delusion and snare. Civilization in the real sense of the term consists not in multiplication but in the deliberate and voluntary reduction of wants.

One may not entirely agree with Mahatma Gandhi regarding the limitation of wants, but in the context of poor underdeveloped economies in which glaring inequalities of income prevail, the restraint on the multiplication of wants of the richer sections of the society is essential if economic surplus is to be generated and used for productive investment. Consumption of luxury and semi-luxury goods should therefore be controlled if rate of capital accumulation is to be stepped up.

Japan and South Asian countries were able to raise the level of their saving and investment to 30 per cent and above of their national income and achieve a high rate of economic growth by cutting consumption to the minimum. Now, the question is how to regulate wants and curtail consumption of luxury goods. One way is the adoption of fiscal measures under which heavy taxes should be imposed on luxurious consumption expenditure by individuals and business companies. Heavy excise duties and sales taxes should also be imposed on luxury goods so as to curtail their consumption by the rich people. Physical controls can be imposed on the production and distribution of luxury goods such as cars, air conditioners. These goods should be distributed to the individuals on functional basis rather than on the basis of money power.

Restricting the Production of Luxury Goods:

But the most effective method to curtail consumption of the affluent is to suitably restrict the production of luxury goods and a much high priority should be accorded to the production of basic consumption goods needed by the masses. This will raise the rate of capital accumulation on the one hand by releasing resources from the production of luxury goods and reduce inequalities between the rich and the poor on the other by raising the living standards of the latter. But the restriction on the production of luxury goods is easier said than done.

This is because luxury consumer goods are produced by the private sector in mixed economies of underdeveloped countries. Guided as they are by the market or effective demand, the private capitalists prefer to produce luxury goods since there is ample market for them by the richer sections. Prof A.K. Dass Gupta rightly states- “The Industrial Policy Resolution of 1956 gives private capitalists the complete sway over the production of consumer goods. Restrictions on imports protect them from international competition. A sheltered market is created in the country for luxury goods. These industries thus receive high priority from India’s capitalists”.