Chapter 4

Development Economics

Question answer

1. Define economic growth.

Economic growth is defined as the increase in the economy's output over time. It is the increase in goods & Services produced by an economy or nation, for a specific period of time. The most common indicator for measuring the economic growth is real Gross Domestic Product (GDP).

2. Define economic development.

Economic development is a multifaceted process embracing economic growth, structural changes in the economy, improving the conditions, and quality of life of the population. It measures all the aspects which include people in a country become wealthier, healthier, better educated, and have greater access to good quality housing.

3. List any four indicators of economic development

The four indicators of economic development are:

a. GDP (Gross Domestic Product)

b. Poverty

c. Human Development Index

d. Physical Quality of Life Index

4. What is HDI?

HDI is the geometric mean of normalized indices for each of the three dimensions. It is one of the indicators of economic development and is calculated as;

HDI = (Health x IEducation x IIncome) 1/3

Where, HDI = Human Development Index

5. What is Physical Quality of Life Index?

It is an alternative indicator to Gross Domestic Product for measuring economic development. It is measured on the basis of three key basis which is shown below:

PQLI (Literacy rate + Indexed infant mortality rate + = Indexed life expectancy)/3 Where, INDEXED Infant Mortality Rate = (166 - infant mortality rate) × 0.625 INDEXED Life Expectancy = (Life expectancy - 42) × 2.7

6. What is poverty?

Poverty is the state where people are deprived of their basic needs like food, cloth, shelter, education, social recognition etc. or a situation where a person is unable to maintain the minimum standard of living. There are two main classifications of poverty:

a. absolute poverty

b. relative poverty.

7. What do you mean by a relative poverty?

It is a situation where people can maintain the minimum standard of living or are above absolute the poverty line but their standard of living is lower compared to other people in the society and nation.

8. What is absolute poverty?

It is a condition where an individual cannot maintain a minimum level of life sustaining resources. Absolute poverty is often defined in terms of poverty threshold. The World Bank defines poverty in absolute terms. A poverty line or poverty threshold set by the world is US$1.90 per day (PPP).

9. Define GDP.

GDP is the market value of all the final goods and services produced within a country in a given period of time. GDP=C+1+G+(X-M) Where, C = Consumption expenditure 1= Gross Private Investment G = Government expenditure X= export

10. What are the characteristics of a developing country?

The characteristics of a developing country are as follows:

a. Low per capita real income

b. High rates of unemployment

c. High population growth rate/size

d. Low levels of productivity

e. Great dependence on agriculture with a backward industrial

f. High proportion of consumption expenditure and low saving rate

g. Technological backwardness

h. Dualism

i. Dependency

11. What is capital formation and what are processes involved in capital formation?

Capital formation involves making or accumulation of more capital goods such as machines, tools, factories, transport equipment, materials, electricity, etc., which are all used for future production of goods and services.

Following are the processes of capital formation:

a. Increase in the volume of real saving

b. Mobilization of savings

c. Investments of savings in creating real assets.

Important Questions and answers

1. Difference between economic development and economic growth.

Economic Growth	Economic Development

Economic Growth is the positive change in the indicators of economy.	Economic development is the quantitative and qualitative change in an economy.
Economic Growth refers to the increment in amount of goods and services produced by an economy.	Economic development refers to the reduction and elimination of poverty, unemployment and inequality with the context of growing economy.
Economic growth means an increase in real national income / national output.	Economic development means an improvement in the quality of life and living standards, e.g. measures of literacy, life-expectancy and health care.
It refers to an increase over time in a country's real output of goods and services (GNP) or real output per capita income.	Economic development includes process and policies by which a country improves the social, economic and political well-being of its people.
Economic growth focuses on production of goods and services.	Economic development focuses on distribution of resources.

2. Explain the indicators of economic development.

The indicators of economic development are discussed below:

1. GNP Index

Economists like Simon Kuznets, Paul Albert, etc. have considered that increase in real GNP in any period of a long run is a good indicator of economic development. An increase in real GNP results in an increase in economic activities and then creates more employment opportunities. It helps to maintain maximum welfare in the society.

2. Per Capita Income Index

In terms of this indicator, development is said to take place if the growth rate of national income exceeds the growth rate of population. It reveals that the country is getting better off gradually and the availability of goods and services has increased. This index is especially suitable in developing countries.

3. Physical Quality Life of Index (PQLI)

PQLI is a common indicator of development. It is computed from life expectancy at birth, infant mortality rate and a literacy rate of a country. If people live longer and are literate, PQLI value will be high. PQLI is measured on a scale of 1 to 100. If its value crosses 50, the country is supposed to be advanced and if the value lies below 50 the nations are supposed to be developing. PQLI as an index was developed by Morris D Morris, which measures only personal facts.

4. Human Development Index (HDI)

The HDI is an indicator introduced by United Nations Development Programme (UNDP) in the World Human Development Report in 1990. Since then, it has been the most popular indicator of development. It measures development in terms of people's real income level, health, education, environment and gender issues. It is a composite index rated from zero to one. It is expressed in three digits after decimal point.

5. Basic Need Approach

This requires on assessment of development in terms of the extent to which the basic needs of the population, in particular of the poor, are satisfied. The approach involves satisfying the minimum levels of physical needs. This line of thinking considers even PQLI as inadequate and less helpful in fighting the many evils of poverty.

3. Explain the characteristics of developing nation.

The characteristics of developing nation are discussed below :

1. General poverty:

There is widespread poverty in developing countries. The general living standard of people is very low due to their low income. That is why; they are not able to fulfill their basic necessities like food, shelter, cloth, etc. Majority of people are both in poverty and die in poverty. They live below the poverty line.

2. Rapid population growth:

There is rapid population growth in developing countries as compared to developed countries. The average annual growth rate of population in developing countries is about 1.5 % to 3 % whereas, in developing countries, it is about 0.7 % or about 1 %.

3. High dependence on agriculture:

Agriculture is the main occupation in developing countries. Majority of the population from 70 % to 80 % are engaged in developing countries whereas in developed countries 15 % or less depends on agriculture. The high dependency on agriculture is due to the low development of the non-agricultural sector.

4. Underutilization of natural resources:

Most developing countries are rich in natural resources. The natural resources in developing countries are either utilized or underutilized due to the various difficulties such as shortage of capital, the small size of the market, primitive technology. Nepal is rich in water resource but it is not being properly utilized due to the lack of capital.

5. Dualistic economic:

Most developing countries have the mixer of two types of an economic system, modern or marketing economy system, modern or marketing economy and subsistence or traditional economy. A market economy exists in limited urban areas where modern facilities can be utilized and the traditional economy exist in most of the rural areas where there are no modern facilities and life is full of difficulties.

4. What is capital formation process? Explain its process.

Capital formulation process making or accumulation of more capital goods such as machines , tools, factories, transport equipment, materials, electricity, etc. which are all used for future production of goods and services.
Capital formation involves making or accumulation of more capital goods such as machines, tools, factories, transport equipment, materials, electricity, etc. which are all used for future production of goods and services. The process of capital formation involves following these steps:-

1. Increase in the Volume of Real Saving:
Savings are done by individuals, households or governments. When individuals or households save, they release resources like workers, natural resources, materials, etc., from the production of consumer goods for the production of capital goods. Government save in the form of taxes and the profit of public undertakings which can be used by the government for building up new capital goods like factories, machines, roads, etc., or it can lend them to private enterprise to invest in capital goods.. Thus in order to increase the stock of capital or for capital formation there must be increase in the volume of real saving. The level of saving depends upon following factors: a. Willingness and ability to save b. Unforeseen contingencies
2. Mobilization of Savings:
The next step in capital formation is the mobilization of saving. It is the process of transferring or moving the savings of households to the businessmen or entrepreneurs for investment. The major factor that assists in mobilization of savings is a well-developed capital market. Capital market is a market where buyers and sellers engage in trade of long-term financial securities like bonds, stocks, etc. The buying/selling is undertaken by participants such as individuals and institutions. In the capital market, funds are supplied by the investors (that may be individual or institution) by buying securities or shares issued by companies, banks, investment trusts, insurance companies, finance corporations, governments, etc. the effective mobilization of savings from individuals to the entrepreneurs depends upon how effective is the capital market in an economy. More effective or developed the capital market is, more effective the mobilization of saving is.

3. Investments of Savings in Creating Real Assets:

Finally when the savings of the individuals are mobilized to the entrepreneurs, it needs to be invested. There must be investors who are willing and able to take risk and bear uncertainty of production for the investment of savings to take place. Investment will be made by them only if there is sufficient inducement to invest. Inducement to invest depends on:

a. Marginal efficiency of capital (i.e., the prospective rate of profit)

b. Rate of interest.

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