

BLOCK 4
INTERNATIONAL COMPARISONS

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BLOCK INTRODUCTION

Block 4: International Comparisons

Block 4 of this course is devoted to presenting an ‘International Comparison’ of major developmental dimensions. This block has four units.

Unit 11 is on ‘**Growth and Structural Changes**’. The unit begins with a theoretical insight into the ‘trends in the inter-sectoral transfer of workforce’. A comparative profile of structural changes in India with other countries is then presented. This is done with a profile each of India versus the developed, the developing Asian and the emerging BRICS countries separately.

Unit 12 provides a comparative international profile of ‘**Social and Economic Development**’. The social dimension is discussed in terms of the ‘education and health status’ while the economic dimension is explained in terms of ‘per capita GDP’ and ‘structural dimension’. A comparative profile of ‘deficits of development’ is then provided in terms of poverty, inequality and unemployment. An outline of various indices of development like the HDI, the social progress index (SPI) and world happiness index is then given.

Unit 13 is on ‘**Trade and Balance of Payment**’. The unit begins with a conceptual outline of the terms like: (i) components of BoP account, (ii) deficit and surplus of BoP account and (iii) the ‘current account deficit (CAD)’. An international comparison of CAD is then presented with reference to the developed and the developing economies. An outline of the efforts made on the ‘liberalisation of capital account in India’ and the factors that influence the ‘current account balance’ are also presented in the unit.

Unit 14 is on ‘**The Role of Governance and Institutions**’. The unit begins with a distinction of the concepts of government and governance. The elements of ‘good governance’ are identified. The constituents of governance, delineated for its economic and institutional dimensions, are then explained. An idea of the various ‘governance indicators’ that have been developed to enable an international comparison is then provided in the unit.

UNIT 11 COMPARATIVE PROFILE OF GROWTH AND STRUCTURAL CHANGES

Structure

- 11.0 Objectives
- 11.1 Introduction
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- 11.3 Comparative Profile of Structural Changes: India Vs. Developed Countries
- 11.4 Comparative Profile of Structural Changes: India Vs. Other Developing Asian Countries
- 11.5 Comparative Profile of Structural Changes: India Vs. Developed and BRICS Economies
- 11.6 Let Us Sum Up
- 11.7 Some Useful Books
- 11.8 Answers or Hints to Check Your Progress Exercises

11.0 OBJECTIVES

After reading this unit, you will be able to:

- discuss the theoretical insights on inter-sectoral transfer of workforce;
- compare the trend in inter-sectoral transfer of workforce in India with the theoretical insight on the same;
- present a comparative profile of structural changes between India and developed countries;
- explain the inter-sectoral transfers in GDP shares in a comparative profile of India with other developing Asian countries;
- define the terms ‘debt to GDP ratio’ and ‘junk status debt’ and indicate their trends for major economies in the recent years; and
- describe the trends in growth rates of India in the recent years (2010-16) in a comparative profile with the world, other developed countries and BRICS economies.

11.1 INTRODUCTION

The process of economic development is historically associated with structural change in national economies. Structural change implies shifts in the shares of GDP and labour force from primary sector to the secondary and tertiary sector. Structural changes not only characterise economic development but are also

* Dr. Asim Karmakar, Jadavpur University

necessary for sustaining economic growth. Kuznets and others have demonstrated that sustained growth is brought about by changes in sectoral composition of workforce. Changes in the structure of an economy would not only be an outcome of the rate of growth but also depends on the nature of development (e.g. human development, inclusive development).

11.2 INTER-SECTORAL TRANSFER OF WORKFORCE: THEORETICAL INSIGHTS AND TRENDS

Pioneering works by Fisher (1935), Clark (1946), Chenery (1960) and Kuznets (1971) suggest that in the early stages of development, the share of agriculture in both output and employment would be overwhelmingly large. But as industrialisation proceeds, the share of agricultural sector in income falls and that of industrial sector rises. Once countries have sufficiently industrialised and reached an advanced stage of economic development, the share of industry also declines while the share of services/tertiary sector rises. After an economy reaches a sufficiently high level of income, the rate of increase in demand for services increases sharply. This is because the services have a higher income elasticity of demand than for the goods of agricultural and industrial sectors.

Rowthorn and Wells (1987) provide a similar description of the pattern of structural change in respect of employment shift in the present day advanced economies. They found that the modern economic growth is associated with a decline in the share of agriculture in total employment resulting in an increase in both the proportion and number of workers engaged in non-agricultural sectors. The non-agricultural sector includes the industrial sector as well as commercial, government and personal and household service (PHS) sectors. In the first stage of development, called the industrial phase, the share of agriculture in total employment continues to decline and a domestic personal service sector builds up. So long as there is surplus labour employed in agriculture and adequate workers in domestic personal services, non domestic services can increase their share of total employment leaving the share of industry unaffected. But eventually, any significant rise in the share of non-domestic services will be at the expense of the industrial sector. The decline in the share of industry and corresponding increase in the share of services in total employment are referred to by Rowthorn and Wells (1987) as the phase of 'de-industrialisation' in the developed countries.

The importance of service sector activity is highlighted in a study of a sample of 123 non-socialist countries for the period 1970-1989 [Kongsemut, Rebelo and Xie (2001)]. The study notes a decline in the share of the agricultural sector, both in output and employment, as an economy matures. The decline is accompanied by an increase in the share of services in output and employment. Hence, as countries develop, there is an increase in the share of service sector economic activity. As a matter of fact, the service sector constituted 70 percent of world GDP in 2016. Using data on a cross section of developed and developing economies over the period from 1950 to 2005, Eichengreen and Gupta (2009) identify two waves of service sector growth: a first wave as a country moves from 'low' to 'middle' income status and a second wave as it moves from 'middle' to 'high' income status.

In case of India, the share of agriculture in GDP declined from 60 percent in 1950-51 to 24 percent in 2002 and further to 17 percent in 2015. The industrial sector increased its share from 16 percent in 1960 to 25 percent in 2002 but thereafter its

increase slowed down (reaching only 25.8 percent in 2015). On the other hand, the share of services sector increased from 21 percent in 1960 to 51 percent in 2002 and 57 percent in 2015. The difference between India and the developed and emerging economies is that while most of the latter entered the phase of predominance of services sector, graduating sequentially from predominance in agriculture, first to manufacturing and then to services, Indian industry failed to show such a trend. It stagnated in the expansion of its industrial sector but leapfrogged to a significant expansion of the services sector. Whether this trend was unique to India or whether it was followed by any other economy too is thus an aspect to which we shall now turn to see.

11.3 COMPARATIVE PROFILE OF STRUCTURAL CHANGES: INDIA VS DEVELOPED COUNTRIES

The historical pattern of structural changes in the presently developed countries have had a similar stage of sectoral structure about 100 to 150 years back as India had at the beginning of its independence. This is to say that most of the developed countries of today, around the year 1900, embarked upon their industrialisation with about 60 percent of GDP accounted for by agriculture. Industry and services contributed about 13 and 27 percent respectively in these economies. Thus, the Indian economy in 1950 was structurally comparable to the economy of the Great Britain in late eighteenth century, of Japan in 1900, of Germany at the beginning of the nineteenth century and United States and Italy of mid-nineteenth century. Similar comparisons hold in respect of the share of labour force in the three leading sectors in which in 1950 India had the relative shares of 73 percent in agriculture, 11 percent in industry and 16 percent in services. This is comparable with the United States of 1841 when it had about 72 percent of its workers in agriculture, 12 percent in industry and 16 percent in services, or Japan of 1880 with the respective shares of employment in the three sectors being 65, 15 and 20 percent. The main features that, therefore, come out from this historical pattern of changes in the economic structure observed in today's developed countries are:

- 1) all developed countries followed a similar sequence of changes in their economic structure with predominance of agriculture before attaining their developed status;
- 2) the structure of the economies of most developed countries is similar in the sense that in their developed state each of them has a miniscule share of agriculture, then a slightly higher share of industry and then a much higher share of services in their national output; and
- 3) the share of each sector's employment, moves in line with the output share of that sector i.e. highest share in employment in the services sector, a medium share in industries and the lowest share in agriculture.

Economic development in India over a period of half a century (1951-2004) experienced the same pattern of structural changes that the developed economies of today underwent over a period ranging backwards by 100 to 150 years. The share of agriculture in GDP declined from around 60 percent in 1950-51 to 17 percent in 2016-17, share of industry increased from 13 to 29 percent and of services increased from 28 to 54 percent over the corresponding period. This pattern of shift has been continuous throughout the period of over half a century but the pace of shift has been faster since 1990-91. The first forty years saw a

decline in the share of agriculture from 60 percent to 35 percent whereas the next 25 years reduced it from 35 to 17 percent. Share of services, on the other hand, increased from 28 to 40 percent in the first 40 years and from 40 to 54 percent in the next 25 years. Share of industry in GDP which had stagnated up to 2003-04 has since picked up to reach the level of 29 percent in 2016-17.

But the most striking feature of the structural change in the Indian economy in recent (two and a half decades) has been the pre-eminence of services sector as the major contributor to growth, raising its share rather sharply in the national output. Industry, particularly manufacturing, which has been observed historically to be the main contributor to growth, at least in the initial period of economic development, has played only a minor role in India's economic growth. While developed countries entered the phase of predominance of services in their economies after going through a major phase of industrialisation where the industry attained a share of 50 percent in the economy, the Indian case is different. India has marched towards a post-industrial 'service economy' without industrialising. Such a swift and a historical transition of an economy, directly from an agricultural to a service economy bypassing industrial development can be explained on two fronts. First, technological advancements over the past few decades have led to increasing demand for services in countries even at a relatively low level of per capita income. Development of communication technologies and movements of people across countries have produced demonstration effect creating similar pattern of demand in developing as well as developed countries leading to larger demand for services. As a result, elasticity of demand for services has become greater than unity even in countries with relatively low per capita income levels. This has led to a rise in the contribution of services in national product. Second, with increasing openness of economies and trade playing significant role in them, changes in demand pattern are met through trade. Trade, thus, has served as a driving force in bringing about this bypassing of industries by services.

Check Your Progress 1 [answer within the space given in about 50-100 words]

- 1) What is the underlying reason for the theoretical insight on the sectoral transition of income first from the primary to the industry and then in the later stages from the industry to the services sector?

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- 2) What does the term 'de-industrialisation' used by Rowthorn and Wells mean?

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- 3) What has been the experience of India in respect of its sectoral share in GDP over the period 1960 to 2015?

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- 4) What are the common features that could be stated from the historical trends of inter-sectoral shares of GDP and employment for today's developed countries and India?

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- 5) How would you compare the pace of structural change in India, in terms of inter-sectoral share in GDP, over the years 1951 to 2017?

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11.4 COMPARATIVE PROFILE OF STRUCTURAL CHANGES: INDIA VS OTHER DEVELOPING ASIAN COUNTRIES

To place the performance of the Indian economy in a comparative framework, we can consider economies of South East Asia and East Asia viz. China, Indonesia, Malaysia, Pakistan, Thailand and Republic of Korea. Share of the agricultural sector in their GDP has decreased for all the countries and that for services sector has increased over the period 1960-2015. Important trends in this respect can be stated as follows.

Share of Agricultural Sector in GDP (agriculture-GDP)

- The share of agricultural sector in GDP was higher than 50 percent in 1960 for only two of these seven countries viz. Indonesia (50 percent) and India (55 percent). By 2015, their respective shares in 'agriculture-GDP' had decreased to 14 percent and 17 percent respectively.
- In 1960, China had the lowest share by agriculture to its GDP than all the other countries (30 percent). By 2015, China is one of the three countries whose contribution to GDP had declined to less than 10 percent (8.6 percent); the other two countries being Malaysia (9.1 percent) and Korea (2.7 percent).
- Even by 2002 itself i.e. by the beginning of the millennium, three countries had achieved decline in their share of agriculture-GDP below the 10 percent

mark. These three countries are: Thailand (9 percent), Malaysia (9 percent) and Korea (4 percent). However, Thailand's share of agriculture-GDP increased to 12.4 percent by 2015.

- Malaysia is notable to have maintained its level although there was a marginal increase in its share of agriculture-GDP to 9.1 percent in 2015. China joined this distinctive category by achieving decline in its agriculture-GDP from 15 percent in 2002 to 8.6 percent in 2015. Korea is the only country whose share of agriculture-GDP had declined below the 5 percent mark by 2015 (2.7 percent).

Table 11.1 : Changes in Sectoral Shares (%) in GDP in Some Asian Countries (1960-2015)

Countries	Agriculture			Industry			Services		
	1960	2002	2015	1960	2002	2015	1960	2002	2015
China	30	15	8.6	49	51	39.8	21	34	51.6
Indonesia	50	18	14.3	25	45	46.9	25	38	38.8
Thailand	40	9	12.4	19	43	44.7	41	48	42.9
Malaysia	36	9	9.1	18	47	41.6	46	44	49.3
Korea	37	4	2.7	20	41	39.8	43	55	57.5
Pakistan	46	23	21.8	16	23	23.6	38	54	54.6
India	55	24	17.4	16	25	25.8	29	51	56.9

Source: Compiled from Papola (2012) and WDR database

- The two points made above are specified with the view that the share of agriculture-GDP to fall below 10 percent is a landmark achievement and to achieve a further decline below 5 percent is a even major landmark to achieve.
- In developed countries the share of agriculture-GDP is very low (e.g. US – 1.1 percent in 2015 and UK – 0.6 percent for same year).

Share of Industrial Sector in GDP (industry-GDP)

- Moving on to the share of industry-GDP, China is the sole country whose industry-GDP share was close to 50 percent in 1960 (49 percent). All other countries had less than 20 percent share of industry-GDP in 1960 with the exception of Indonesia (25 percent).
- However, China's share of industry-GDP slid down below 40 percent mark by 2015 (39.8 percent). This is a steep reduction although a reduction in industry-GDP over 2002-15 is observed for Malaysia and Korea too.
- Korea had increased its industry-GDP from 20 percent in 1960 to 41 percent in 2002 but since then there has been a slight decline to 39.8 percent in 2015.
- Share of industry-GDP was similar for three countries viz. Indonesia, Thailand and Malaysia. This is in the sense all three had their industry-GDP share closer to the 20 percent range in 1960 (Indonesia, 25 percent; Thailand, 19 percent; Malaysia, 18 percent). By 2002, all these three

countries along with Korea had crossed the mark of 40 percent in their industry-GDP share (Korea, 41 percent; Thailand, 43 percent; Indonesia, 45 percent and Malaysia 47 percent). More notably, over the next 10+ years i.e. by 2015, Indonesia and Thailand had marginally increased their industry-GDP share (to 47 percent and 45 percent respectively), whereas, for Malaysia and Korea there was a decline in this respect (to 41.6 percent and 39.8 percent respectively).

- Both India and Pakistan are outliers in respect of their industry-GDP share i.e. both had the same share of 16 percent in 1960 and both had not only marginally improved their industry-GDP share by 2002 (to 25 and 23 percent respectively) but both demonstrated a stagnancy with a very marginal increase in their industry-GDP share over 2002 to 2015 (to 25.8 and 23.6 percent respectively).
- Over 2002 to 2015, the stagnancy observed in industry-GDP share in India and Pakistan had also set-in in Korea, Indonesia and Thailand with varying degrees marginally differing from each other (Table 11.1). However, the structural shift or change is marked for an expansion of industry with a corresponding decline in agriculture-GDP (i.e. as the historical trend revealed for the developed economies and also as the theoretical insights had outlined) more markedly for all countries except India and Pakistan. The expansion of industry is not to the extent as in other five economies for these two countries.

Share of Services Sector in GDP (service-GDP)

- The highest shift over the period 1960-2015 in the service-GDP is for China (30.6 percent) followed by India (27.9 percent) i.e. 31 percent and 28 percent rounded to the nearest digit.
- Malaysia is an outlier in the sense that it had reached its peak level in 1960 itself in its service-GDP (46 percent) and over the next 55 year period its service-GDP share has increased by the smallest measure among all these seven economies (i.e. 3.3 percent).
- Thailand and Korea are the other two economies whose service-GDP share was higher than 40 percent in 1960. Korea has seen an increase of 14.5 percent since then up to 2015 whereas Thailand had increased its service-GDP share by 7 percent up to 2002 but has since experienced a steep decline to 43 percent in 2015. This means over the long term horizon of 1960-2015, Thailand's increase in service-GDP is the lowest i.e. a mere 2 percent.
- Pakistan's service-GDP had increased by 16 percent over the period 1960-2002 to reach the level of 54 percent but has since shown stagnation – its share in service-GDP having risen only by 0.6 percent.
- India experienced the highest increase in service-GDP over the period 1960-2002 i.e. by 22 percent. Its increase in this respect over the period 2002-15 has been modest at 5.9 percent (i.e. 6 percent rounded).

Employment Shift over 1991-2017

- Shift of labour force from agriculture has been slower than that in GDP in all countries. Over the period 1991-2017, China has managed to reduce their agricultural sector employment by half) from 55 to 27 percent [Table 11.2].

During this period, India has managed to reduce it by one-third (from 63 to 44 percent). Japan stands out as the country employing least workforce in agriculture (single digit for both time points).

- Share of industry in labour force shows that four countries viz. Malaysia, Sri Lanka, Philippines and Pakistan have experienced a period of stagnation for employment absorption in their industries. In contrast, India has increased its share of industrial employment from 15 to 25 percent. With this percentage increase, India is the second among these 10 countries (first is Vietnam where there is a 14 percent increase) to have created industrial employment of this magnitude as all other countries have done less than this [e.g. China, 6%; Indonesia, 8%].
- What distinguishes India from other countries of this group is the difference in the absorption of employment by the services sector. In all other countries, the share of services sector has increased more or less in tune with that of GDP. However, in India the employment share has shown much smaller increase than the shift in the GDP share to the services sector. This means, whereas the services sector is the major economic sector in terms of its contribution to GDP, it is a minor contributor to employment.
- In services sector, all the 10 countries without exception have had their employment share increased. However, countries which have managed to achieve an increase of more than 15 percent over this period (1991-2017) are: China (23 percent), Thailand (18 percent), Vietnam (17 percent) and Malaysia (15 percent). Indonesia and Japan have increased their services sector employment by 13 and 12 percent respectively. India, with a 9 percent increase in this respect, is among the three countries which have managed to create additional employment avenues in the services sector of the lowest order [the other two countries in this bracket being Philippines (8 percent) and Pakistan (5 percent)].

Table 11.2: Share of Employment by Major Sectors (Percentage to Total Employment)

Major Asian Economies	Agriculture		Industry		Services	
	1991	2017	1991	2017	1991	2017
China	55	27	19	24	26	49
India	63	44	15	25	22	31
Indonesia	53	31	14	22	33	46
Japan	7	4	35	27	58	70
Malaysia	26	12	27	27	46	61
Pakistan	48	42	20	20	33	38
Philippines	43	28	15	16	42	50
Sri Lanka	42	27	26	26	32	47
Thailand	60	34	15	23	25	43
Vietnam	73	42	9	23	18	35

Source: ILO [<http://www.ilo.org/global/statistics-and-databases>]

Check Your Progress 2 [answer within the space given in about 50-100 words]

**Comparative Profile
of Growth and
Structural Changes**

- 1) Which are the only two countries which had its agriculture-GDP share more than 50 percent in 1960? What are their current levels in this regard (in 2015)?

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- 2) Which country had the lowest share of all others in 1960 in agriculture-GDP? What is its share in 2015? Which are the other two countries which have also achieved this level in 2015?

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- 3) In what respects, Korea stands out as unique among all these 7 countries in comparison?

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- 4) In respect of industry-GDP, what is notable about China?

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- 5) Why are India and Pakistan outliers in respect of their industry-GDP?

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- 6) Which are the two countries that have experienced the highest shift in services-GDP over the period 1960-2015?

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- 7) How does Thailand stand out in respect of its Services-GDP?

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- 8) What is remarkable about the Indian services sector in comparison to other economies?

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11.5 COMPARATIVE PROFILE OF STRUCTURAL CHANGES: INDIA VS DEVELOPED AND BRICS ECONOMIES

Structural change in economies would indirectly derive from the growth rates experienced at the overall economy level. Both the growth rates achieved and the resulting structural changes are a reflection of overall policy and institutional insights. From this point of view, although not directly, taking a look at the comparative profile of overall economic growth rates is useful. A comparative profile of this scenario for a mix of countries comprising of developed and the developing or emerging economies is presented in Table 11.3. Major features that flow from the figures therein are the following.

Table 11.3: Comparative Growth Profiles for Developed and BRICS Economies (%): 2010 to 2016

Year	World	USA	Euro-zone	Germany	Japan	Brazil	Russia	India	China	South Africa
2010	5.2	3.0	1.8	3.6	4.4	7.5	4.5	9.9	10.4	5.4
2011	3.8	1.8	1.5	3.0	-0.9	3.9	4.3	7.4	9.2	4.4
2012	2.4	2.2	-0.9	0.5	1.5	1.9	3.5	5.6	7.8	3.8
2013	2.6	1.7	-0.3	0.5	2.0	3.0	1.3	6.4	7.8	4.8
2014	2.8	2.3	1.2	1.6	0.4	0.5	0.7	7.5	7.3	4.6
2015	2.7	2.6	1.5	1.7	1.2	-3.8	-2.8	8.0	6.9	3.3
2016	2.4	1.6	1.8	1.9	0.9	-3.6	-0.2	7.1	6.7	1.2

Source: World Bank database

- The global economic growth rate has halved over the short term period of 2010 to 2016 from 5.2 percent in 2010 to 2.4 percent in 2016 (Table 11.3). In particular, the US economy's growth rate has also slid down from 3 percent in 2010 to 1.6 percent in 2016. A similar declining growth trend is noticed for Germany (from -3.6 percent in 2010 to 1.9 percent in 2016), Japan (from 4.4 percent in 2010 to 0.9 percent in 2016) and South Africa (from 5.4 percent in 2010 to -1.2 percent in 2016)
- Economies of Euro-zone, Japan, Brazil and Russia have experienced negative growth rates for some year or the other during the period 2010-16. In particular, Brazil's economy has slumped from a high of 7.5 percent growth in 2010 to a low of -3.6 percent in 2016 and of Russia from 4.5 percent growth in 2010 to -0.2 percent in 2016.
- India and China are two countries which stand apart in this regard. Both the countries have experienced declining growth performance in their economies, in tune with the global trend, but from a high growth rate in 2010 to a lower growth rate in 2016. While China's growth rate has declined from 10.4 percent in 2010 to 6.7 percent in 2016, India's growth rate has declined from 9.9 percent in 2010 to 7.1 percent in 2016.

A number of downside risks continue to linger on the horizon. These include: (i) continued sluggishness of the global economy, (ii) possible capital outflows consequent upon the recent increase in the interest rate in USA, (iii) a possible reversal of the global oil price trends, (iv) inadequate monsoon rainfall and financial market vulnerabilities. Besides recession in some economies as noted above, a growing trend of concern in many economies has been the increasing debt-to-GDP (DTG) ratio. For instance, China experienced a high DTG ratio of 250 percent. Likewise, as per two rating agencies, Brazil's DTG has been demoted to a junk status.

11.6 LET US SUM UP

Structural change during the development status is theoretically expected to result from agricultural to industry and then from industry to services sectors. Such a change is a reflection of rising incomes and better living conditions. Many developed economies have experienced this type of transition in the course of their development. However, some emerging economies like India have reached a higher share of services sector in GDP with their industrial GDP share having remained low at around 25 to 30 percent. This is in contrast to some other economies like China, Indonesia, Thailand, Malaysia and Korea all of which have a stronger industrial base of around 40 to 50 percent. One of the reasons for such a skip over of the industrial sector's expansion i.e. directly to services sector dominated share in the GDP, is the impact of 'international trade'. This is also aided by the developments in the communication technologies and people's movement across countries. There is a declining trend in the overall economic growth rates experienced by many developed countries with many advanced economies like US, Germany and South Africa registering half of their growth rates in more recent years like 2016 as compared to what they achieved in 2010. India and China are two countries standing out as exceptions to this declining trend. An yet another striking feature of services sector's dominance in countries like India is its relative low employment absorption potential.

11.7 SOME USEFUL BOOKS

- 1) Kuznets, S (1966). *Modern Economic Growth: Rates, Structure and Spread*, Oxford and IBH Publishing Co.
- 2) Kuznets, S. (1971). *Economic Growth of Nations: Total Output and Production Structure*, Cambridge: Harvard University Press.
- 3) Papola, T. S. (2008). Emerging Pattern of Indian Economy, *The Indian Economic Journal*. Vol.54, No.1, April –June.
- 4) Papola, T. S. (2005). ‘Structural Changes in the Indian Economy: Some Implications of the Emerging Pattern’, *Artha Beekshan*, Vol. 13, No. 4,
- 5) Rakshit, Mihir (2007). Services Led Growth: The Indian Experience, *Artha Beekshan* , Vol.15, No. 4.

11.8 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

- 1) This is because of the reason that the services have a higher income elasticity of demand as compared to the goods of primary and industrial sectors.
- 2) The phrase is referred to in the sense that increase in the share of employment, after a certain phase of industrial development, will be solely at the cost of industrial sector’s employment share i.e. decline in the share of industry is matched by the corresponding increase in the share of service sector’s employment.
- 3) Share of agriculture in GDP decreased substantially from a high of 60 percent in 1951 to 17 percent in 2015. However, while the share of industry’s income in GDP rose from 16 percent to 25 percent over 1960 to 2002 but thereafter nearly stagnated (by reaching up to only 25.8 percent by 2015). For the services sector the increase was significant: from 21 percent in 1960 to 57 percent in 2015.
- 4) These are: (i) in GDP the developed countries had a predominant contribution from agriculture (between 65 to 72 percent) followed by industry (12 to 15 percent) and services (16 to 20 percent). For other common features, see Section 11.3 and answer.
- 5) The pace of change has quickened since 1991. Agricultural share decreased from 60 percent to 35 percent up to 1991 (i.e. a decline of 25 percent) but by 2017, it had further fallen to 17 percent (i.e. by another 18 percent since 1991). Share of industry which had increased by a mere 0.8 percent, from 25 to 25.8 percent over the period 2002 to 2015, has suddenly improved its share to touch 29 percent in 2017. Share of services sector has increased from 28 to 54 percent over the period 1951-2017.

Check Your Progress 2

- 1) Indonesia and India. 14 percent and 17 percent respectively.
- 2) China (30 percent); 9 percent in 2015. Korea and Malaysia are the other two

countries (3 and 9 percents respectively). In fact, Malaysia and Korea had achieved this level of less than 10 percent share in 2002 itself. But Malaysia's share in 2015 in its agriculture-GDP has increased to 12 percent.

- 3) Korea is a unique case which has most exactly followed the theoretical insights indicated by literature. Not only its agriculture-GDP is the lowest and below 5 percent level, a distinction it had achieved in 2002, its industry-GDP had doubled from 20 percent in 1960 to 41 percent in 2002 – a level it has nearly consistently maintained up to 2015. Further, its rising services-GDP is consistent (i.e. without any sign of decline or stagnancy as seen in case of other countries).
- 4) First, it is the only country which had the highest and close to 50 percent share even in 1960 (49 percent). Second, whereas in all countries there is an increase in industry-GDP, China is the only country where there has been a steep decline (from 51 to 40 percent over 2002-15).
- 5) They are the two countries with the lowest of industry-GDP. Secondly, they have nearly stagnated in this respect over the period 2002-15.
- 6) China and India (31 percent and 28 percent).
- 7) It had one of the highest services-GDP in 1960 itself (i.e. more than 40 percent). And over the long term time frame of 1960-2015, its services-GDP has increased by a mere 2 percent.
- 8) The shift of services-GDP is higher. Corresponding shift in employment is smaller.

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UNIT 12 SOCIAL AND ECONOMIC DEVELOPMENT OF INDIA *

Structure

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- 12.3 Economic Dimension
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 - 12.4.1 Poverty
 - 12.4.2 Unemployment
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- 12.5 Social Dimensions of Development
 - 12.5.1 Educational Status
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 - 12.6.1 Human Development Index
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- 12.8 Some Useful References
- 12.9 Answers or Hints to Check Your Progress Exercises

12.0 OBJECTIVES

After reading this unit, you will be able to:

- state the limitations of using ‘per capita income’ as a basis for inter-country comparative profile;
- specify a framework for drawing a comparative profile of countries for their social and economic development;
- outline the ‘economic dimension’ of India’s growth profile with other countries over a long term time frame of 1961-2018;
- highlight the principal differences in the economic growth profiles of India with those of Sri Lanka and China over the period 1961-2018;
- present an account of the ‘deficits of development’ in India in a comparative profile with other economies;
- contrast the social sector development in India with other economies; and
- write a note on ‘comprehensive indices of development’.

12.1 INTRODUCTION

Ever since the end of the Second World War, and the gradual end of colonialism in most of the newly independent countries including India, 'development' is considered as most important for achieving better living conditions for people. Development was initially conceptualised as achievement of higher levels of GDP and GDP per capita. For this, the targets for achieving development were set in terms of growth rates in national income. The levels of development of countries were measured in terms of the levels of per capita incomes. Measuring development in per capita income terms helped in: (i) differentiating countries as developed and developing, and (ii) identifying the financial assistance needed for developing countries by multilateral institutions like International Monetary Fund and the World Bank.

While the measurement of countries' development in per capita terms continues, questions have been raised about the adequacy of considering the level of per capita income to reflect the living condition of people. It is rightly argued that per capita income is only an average and does not reflect the distribution of income. This criticism is well reflected in cases of those countries which enjoy high per capita income but lack basic achievements of development in terms of capabilities and freedom. Hence, per capita income is only a means for better living but not adequate for development. For development, it necessarily should be seen in conjunction with population size and gender equality level. This argument has given a fillip to the concept of development from a multidimensional perspective. In other words, a measure of development should consider many dimensions of socio-economic significance. Such measures, compositely defined and constructed, should then be taken as a basis for making inter-country comparisons. In the immediate foregoing section of the present unit, a broad framework for making a comparison of countries for assessing their levels of social and economic development is outlined. Based on this framework, the subsequent sections present a comparative profile of India's development with those of other select economies. The basis on which this sample of select economies is chosen is also outlined in the section below.

12.2 FRAMEWORK FOR INTERNATIONAL COMPARISON

The factors which need to be considered are: (i) basic 'economic dimensions' like size of population, GDP, per capita income, growth in GDP, share of agriculture in total employment and GDP; (ii) deficits of economic development in terms of levels of poverty, hunger, inequality and unemployment; (iii) progress in social dimensions of development like education, health and gender development status; and based on all these three (iv) a comprehensive index or indices of social progress like human development. We proceed in the subsequent sections in this very order making in each a comparative assessment of India's status with those of other select economies. For making a selection of countries for comparison, we keep one country from each of the five continents restricted to Asia, Africa, North

America, South America and Europe. Specifically, we include the following countries cutting across the developing and the developed divide: India, Bangladesh, Nepal, Pakistan and Sri Lanka (from South Asia), China from East Asia, Brazil from Latin America, South Africa (from Africa), USA (from North America) and United Kingdom (from Europe). We limit our comparative profile to these ten countries here. Together, the ten countries account for more than half (51 percent) of world's population. In particular, China and India taken together account for more than one-third (36.6 percent) of world population. Hence, whatever development could be achieved in these two countries will have significant impact for global human progress.

The World Bank for its differential lending purposes groups countries into four categories viz. (i) low-income countries with per capita income of less than \$ 1025 (2018), (ii) lower middle-income countries with per capita income of \$1026-\$3995, (iii) upper middle-income countries with \$3996-\$12375 and (iv) high-income countries with per capita income of \$12376 or more. According to this classification, out of the ten countries kept in our sample, the four South Asian countries, except Sri Lanka (which qualifies as a upper middle income country), are in the low middle-income group. Along with Sri Lanka, China, South Africa, and Brazil are also in the upper middle-income group. USA and UK have always been in the high-income group. You must note that, over time, positions of countries change within the four groups and hence it is necessary to keep oneself updated by referring to the World Bank's publication on Development Indicators. For instance, Sri Lanka has been a recent entrant into the upper middle income group while Nepal has recently moved up from low-income to lower middle income group.

12.3 ECONOMIC DIMENSION

The Asian countries, except China, during this long period of 1961-2011, were languishing in a relatively low growth rate scenario (defined as below 4 percent average annual growth in GDP) [Table 12.1]. Their growth rates varied from a low of 1.4 percent for Nepal to a high of 3.3 percent for Sri Lanka. China was an exception which recorded the highest growth rate of 6.8 percent averaged over the long term period of 50 years. But in recent years, in 2018, all these countries, except Sri Lanka, have moved up to high growth trajectory (defined as 'above 5 percent'). Typically, the developed countries are notable for their low growth rate in the range of 0-2 percent. This is because developed countries have better established (i.e. formal) structural base. This contributes to many factors of production and distribution being at a state of near equilibrium from where further ICOR (incremental capital output ratio) would be comparatively less than that in developing countries. Further, developed countries have large GDPs relative to their population and labour force. All these factors are the opposite in case of developing countries where technological infusion has a tendency to yield higher ICOR return.

Table 12.1: Economic Dimension of Development

Social and Economic
Development of India
in A Comparative
Perspective

Country	Population 2018 (millions)	Per Capita GDP 2018 (Current US \$)	Average Annual Growth Rate of GDP: 1961-2011	Growth Rate 2018	Share of Agriculture in GDP (%) 2018	Share of Agriculture in Total Employment 2018 (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
India	1352	2010	3.1	6.8	14.6	43
Bangladesh	161	1698	1.37	7.9	13.1	40
Nepal	28	1033	1.4	6.7	25.3	70
Pakistan	212	1482	2.6	5.8	22.9	41
Sri Lanka	21	4102	3.3	3.2	7.9	26
China	1392	9770	6.8	6.6	7.2	27
South Africa	57	6374	NA	0.8	2.2	5
Brazil	209	8920	NA	1.1	4.4	9
USA	327	62795	NA	2.9	0.9	1
UK	66	42944	NA	1.4	0.6	1

Source: 1. Except for Col. 4 (growth rate for 1961-2011), World Bank Development Indicators.
2. For Col. 4: Dreze and Sen (2013).

12.3.1 Per Capita GDP

In terms of per capita GDP, among the four South Asian countries, India's position is second (\$2010 in 2018). Sri Lanka's per capita GDP is nearly twice that of India (\$4102). But China's per capita GDP is one of the highest: it is more than twice that of Sri Lanka's (\$9770). The per capita GDP of the two high income countries in our sample is many times more than even China (4 times higher for UK and 6 times higher for USA). The PCI of South Africa and Brazil are lower than that of China but higher than that of Sri Lanka (\$6374 and \$8920 respectively).

12.3.2 Structural Dimension

Progressing towards higher levels of income would involve structural transformation from the predominantly agrarian stage (defined as more than 40 percent of workforce engaged in agriculture) to that in manufacturing and services. From this yardstick, four countries viz. India, Bangladesh, Nepal and Pakistan have workforce in agriculture in the range of 40-70 percent (Bangladesh 40 percent and Nepal 70 percent). Relatively higher dependence on agriculture for income and employment reflect lower level of development. This is because the per capita productivity (defined as the ratio of income to workforce) pulls down the overall economy's PCI due to the dependency of higher proportion of workforce (with a lower share in its income/GDP) on agriculture. The above four countries are having their GDP share from agriculture high (in the range of 10-25

percent: from 13 percent in Bangladesh to 25 percent in Nepal). With structural transformation from agriculture to industries, developed countries tend to have not only the lowest share of their workforce in agriculture but the sector's contribution to GDP also become lowest. Both USA and UK are notable in this respect with just 1 percent of their workforce depending on agriculture with their GDP share too at less than 1 percent.

Finally, it is noteworthy to highlight the following three principal differences in the economic growth profiles of India with Sri Lanka and China (the two neighbours who have progressed impressively, one with as large a population as India and the other with much smaller population base: only 21 million in 2018) over the long term period of 1961-2018.

- India and Sri Lanka have both experienced nearly equal GDP growth of just above 3 percent average annual but owing to a huge difference in the population dimension, the per capita GDP of Sri Lanka is twice that of India.
- Although China's growth rate was twice that of India over the nearly 60 year time frame, in 2018, the two country's growth rate was nearly equal (6.8 percent for India and 6.6 percent for China). This is revealing of the fact that even though China took a giant leap in economic growth, India too has caught up with China in more recent years.
- The employment share of agriculture in China and Sri Lanka are both comparatively lower and nearly equal (27 and 26 percent in 2018 respectively). Indian comparative share of agriculture employment is still much higher (43 percent in 2018).

Check Your Progress 1 [answer within the space given in about 50-100 words]

- 1) Why is PCI considered limiting particularly for international comparative purposes? Nevertheless, how is still used for international comparison purpose?

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- 2) Specify an analytical framework for drawing a comparative profile of India with other economies?

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- 3) What variables are considered for an analysis of 'economic dimension' of development? How does India figure in this respect in a comparative profile with other countries?

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- 4) In what respects comparison between India, Sri Lanka and China stand out?

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- 5) Why is Bangladesh and Nepal notable for their development achieved?

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- 6) What is meant by 'structural dimension of development'? Why is Sri Lanka notable in this respect?

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12.4 DEFICITS OF DEVELOPMENT

In the post-Second World War era, many developing countries launched focussed strategy of planned economic growth. It yielded results of relatively higher growth rates in some countries but not in India till the late 1990s. By 1970s, it was realised that high rates of growth in many of these countries did not improve the condition of living of large majority of people. In other words, in spite of relatively higher growth rates, not only high levels of poverty and unemployment persisted but income inequalities too increased. There was an increasing criticism on an obsession for growth with a focus only on increasing the GDP without addressing the issue of its reach to the lower segments of the population. This called for attention to 'deficits of development' in terms of poverty, unemployment and inequality. Because of this demand, there was a focussed

attention on a direct effort on poverty alleviation programmes and employment generation strategies.

12.4.1 Poverty

For measuring poverty, every country has evolved a poverty-line based on norms of per capita calorie consumption and consumption of certain essential items like fuel, clothing and transport. Further, in order to have a common base for inter-country comparison, the concept of ‘per capita consumption of Purchasing Power Parity (PPP)’ is evolved. The norm for PPP is changed to account for rise in prices with its present level fixed at \$1.90 per day. Although there has been a decline in the poverty levels over time, still, almost one-fourth of the population in South Asian countries (except Sri Lanka) have their poverty ratios above the 20 percent level (Table 12.2). Since large populations amount to larger number of persons below the poverty level, in absolute terms, as many as 280 million people (in 2011) were below poverty level in India. It is important to note that poverty has an inverse relationship to per capita income (PCI) i.e. higher the PCI lower is the poverty level. For instance, China with a PCI of 9770\$, has the lowest poverty ratio of 3.1 percent, Sri Lanka with a PCI of 4102\$, has the next lowest poverty ratio of 4.1 percent, etc. Typically, India, Bangladesh and Pakistan have more than one-fifth (20 percent) of their population with their PCI also being low in the range of 1000-2000 dollars. South Africa is an extreme case where even though its PCI is higher at 6374\$, its poverty ratio is also very high at 56 percent (in 2014).

Table 12.2: Deficits of Economic Development

Country	Poverty Ratio (% Below PPP 1.9 \$ per day)	Unemployment Rate (% of Labour force – 2018)	Inequality (Gini Index) 2018
(1)	(2)	(3)	(4)
India	21.9 (2011)	6.5*	40.8
Bangladesh	24.8 (2016)	4.3	46.4
Nepal	25.2 (2010)	1.2	32.8**
Pakistan	24.3 (2015)	3.0	32.1
Sri Lanka	4.1 (2016)	4.3	48.9
China	3.1 (2017)	4.4	48.8
South Africa	55.5 (2014)	27.3	69.6
Brazil	NA	12.2	52.5
USA	NA	3.9	39.0
UK	NA	3.8	32.0

*India's unemployment – PLFS 2017-18,

**World Bank Database

Source: 1. For Poverty Rate and Unemployment: World Bank Database.
2. For inequality, World Inequality Database, World Institute for Economic Development and Research (WIDER).

12.4.2 Unemployment

Interpreting unemployment across countries needs caution. This is because of considerable informal sector's presence in developing countries since poor cannot afford to be unemployed. They would accept any work regardless of level of wages and duration of employment. Thus, they end up reporting employed even though they are often underemployed at very low wages. Therefore, in relatively less developed countries like India where close to 90 percent of employment is informal, unemployment is often reported very low (6.5 percent in 2018: Table 12.2). The higher rates of unemployment in South Africa (27 percent) and Brazil (12 percent) are due to higher proportion of formal employment in which scope for under-employment is less i.e. either one gets formal employment or one is unemployed. In contrast, in all developing economies, there is both high proportion of disguised unemployment in informal sector and high proportion of open unemployment due to lack of jobs in formal sector.

12.4.3 Inequality

Although many developing countries, including India, started their development strategy with an emphasis on growth with distributive justice, over the years there has been increase in inequality. It is ironical but true that when these economies were on low growth path, inequality was very low. But as they moved to higher growth trajectory, inequality also started increasing. Such high degree of inequality is observed to be disconcerting, so much so that it is now seen as a major development challenge. Conventionally, inequality in income distribution has been expressed as a Gini Ratio (i.e. a percent obtained by multiplying the Gini coefficient by 100). But since data on income itself is hard to obtain in developing economies (again due to the large scale presence of informal employment), estimation of income is indirectly made on the basis of household consumption surveys. Inequality estimates based on consumption data underestimates inequality. However, more recently, due to the initiative of the World Inequality Database (WID), data on income is generated for all countries based on novel methods employed to make the data comparable between countries. The data on inequality by WID (Table 12.2) shows that among the South Asian developing countries, inequality ranges from 32 percent in Pakistan to 49 percent in both China and Sri Lanka. Further, with rise in incomes, there is a steep increase in inequality in developing countries. This is also true of South Africa which has the highest Gini Index of 70 percent (one of the highest in the world next only to some middle-east countries). Another example is Sri Lanka which, though figures much better in most of the development indicators, has the highest inequality Index of 49 percent (same as China) in South Asia. For developed countries, it ranges from 32 percent in UK to 39 percent in USA, a level comparable to South Asian economies of Nepal, Pakistan and India.

Check Your Progress 2 [answer within the space given in about 50-100 words]

1) What is meant by 'deficits of development'?

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- 2) Is it true that with increase in PCI, poverty too comes down? Can there be an exception to this inverse relationship? Give examples.

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- 3) Why is measurement of unemployment an issue in developing countries?

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- 4) What efforts have been made to generate data on income which is comparable across countries? What does such data reveal for inequality across countries?

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- 5) What is the extent of inequality in developed countries? How does this compare with those in the developing countries?

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12.5 SOCIAL DIMENSIONS OF DEVELOPMENT

Ever since questions were raised about the limitations of the per capita income as a measure of development, there has been an effort to expand the domain of development. The deficits in development, like persistence of poverty and unemployment, are seen as consequence of single-minded attention to growth of GDP and GDP per capita, to the neglect of social dimensions like education and health. In the last two decades, there has been a growing attention paid to education and health dimensions of development. This is mainly owing to the realisation that improvements in educational and health status are of prime importance in increasing the capabilities of people. Improved capabilities, in turn, help in increasing the productive performance of people and better utilise the various goods and services. In this section, we shall examine the status of the countries in terms of indicators of education and health.

12.5.1 Educational Status

Conventionally, 'adult literacy rate' used to be taken as an indicator of educational status. This was expected to reveal historical neglect or achievement in the educational status of people. But currently, educational achievements are discussed in terms of 'access, equity and quality' of education. In keeping with this trend, the focus here is kept on 'access to different levels of education'. On quality, the indicator of 'learning poverty' as defined by World Bank (WB) is considered. 'Learning poverty' is defined by WB as 'being unable to read and understand a short, age appropriate text by age 10'. This index has focus on early childhood and school education.

Adult literacy ratio gives a broad indicator of educational status of a country. Its relative lower levels indicate the inadequate attention to education. Adult literacy rate in India (74%) is better than Pakistan (59%) and Nepal (68%) but other countries [Sri Lanka (92%), South Africa (87%) and Brazil (93%), China (97%)] are far ahead in this respect [Table 12.3]. In terms of 'access to school education', access to primary education being almost 100 percent in most of the countries, the 'gross enrolment rate (GER) in secondary education' is considered here. In this respect, among the countries of South Asia, except Sri Lanka, the other four countries still have a little over one-fourth of the relevant age group 'out of school'. Pakistan, with a GER in secondary education of 43 percent is behind the other countries in this region.

Table 12.3: Status of Education Development in a Comparative Perspective (2018/2019)

Country	Adult Literacy Rate (%)	Gross Enrolment in Secondary Education	Gross Enrolment in Tertiary Education	Mean Years of School (for 25 + pop)	% of Pop. Completed Lower Secondary Education	Public Expenditure on Education (% to GDP)	Quality of School Education (Learning Poverty)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
India	74	73	28	6.5	37.6	3.8	54.8
Bangladesh	74	73	21	6.4	43.6	2.0	57.2
Nepal	68	74	12	3.5	26.9	5.2	NA
Pakistan	59	43	9	5.0	36.4	2.9	74.5
Sri Lanka	92	98	20	10.9	81.6	2.8	14.4
China	97	88	51	10.6	65.3	1.9	18.2
South Africa	87	105	22	10.2	72.3	6.2	79.8
Brazil	93	101	51	8.0	60.0	6.2	48.4
USA	-	99	88	13.8	96.0	5.0	7.9
UK	-	126	60	13.2	99.7	5.5	3.4

Source: World Bank Database on World Development Indicators.

There is a growing concern that with increasing bias of future jobs towards higher skill capabilities, the minimum requirement of education for entry into employment would be secondary school completion. In this respect, Sri Lanka with 98 percent enrolment in secondary education stands out as the best achiever in South Asia. However, there are two dimensions to school education. One is enrolment and the other is 'completion of the school education at different levels'. From this angle, the 'mean years of schooling' for the population in the age group of 25 years or more is lowest in Nepal (3.5 years). This is followed by Pakistan (5 years), Bangladesh (6.4 years), India (6.5 years), Brazil (8 years), China (10.6 years) and Sri Lanka (10.9 years). In developed countries, it is still higher (UK, 13.2 years; USA, 13.8 years). When we take the gross enrolment rate (GER) in tertiary education, India (28%) scores better than other South Asian countries including Sri Lanka (20). But it is much behind China and Brazil (51% for both). This is much higher for UK (60%) and USA (88%). There is a widely shared view that in most of the developing countries public expenditure on education is much lower than the minimum required (considered 6% of GDP). Interestingly, this is indeed so not only in most of South Asia and China (1.9%) but even in USA (5%) and UK (5.5%). This may be because in high-income countries much of higher education is privatised. Further, the GDP of countries like USA and China being many more trillions of dollars higher than that of India, even smaller percentages for these countries also would be higher in absolute terms.

On quality of education, we use the estimates for 'learning poverty'. Since this index lays emphasis on reading skills, in a way it focuses on foundational learning in many subjects. It is measured as a combination of 'out of school children' and the 'proportion of children in school who have not achieved minimum reading proficiency'. This therefore is a measure of 'quality of school education'. For India and Bangladesh the learning poverty ratios are 55 and 57 percents respectively. This means that close to two-thirds of children in these two countries are not able to demonstrate the expected learning skills. The corresponding percentage for other countries are: China (18), Sri Lanka (14), USA (8%) and UK (3%). This means, in relative terms, the quality of education in these countries is markedly higher.

12.5.2 Health Status

The condition of health of people is an important dimension of development which may not reflect clearly with focus on only per capita income. Likewise, mere high years of life expectancy also may not reflect other aspects of health. For instance, female life expectancy in almost all countries is higher than that of male. But this does not mean that the health condition of women are better than men. It is, therefore, necessary to consider a range of indicators for health (Table 12.4). Life expectancy in India (69) is less than Bangladesh (72) and Nepal (70). These two countries are better off even with respect to 'infant mortality rate' (IMR) [Bangladesh (25), Nepal (27), India (30)]. Sri Lanka's IMR is lowest (6) and is comparable to China (7), USA (6) and UK (4). Maternal Mortality Rate (MMR) is very high in all the South Asian countries (>140) except Sri Lanka (36). A more disturbing feature is the high rate of malnourishment which reflects a form of 'stunting and wasting' in children below five years. Stunting is high in India, Bangladesh and Nepal (>35 in all these 3 countries) and it is much more critical in

Pakistan (45). High levels of stunting is an indicator of poor health in early childhood which has an adverse impact on the productive potential in adulthood. The performance of China on health indicators is therefore comparable to the developed countries like the USA and UK.

Two major determinants of a country's health status are: (i) public expenditure as a percentage of total health expenditure and (ii) government expenditure on health expressed as percentage of GDP. The four poor performing countries among South Asia (viz. India, Bangladesh, Nepal and Pakistan) are also the countries where the public expenditure on health is least (<30%). This means that almost three-fourths of health expenditure in these countries is met 'out-of-pocket' i.e. private expenditure. Government expenditure on health as a ratio of GDP in these countries is also low (ranging from 0.4% of GDP in Bangladesh to 1.2% in Nepal). The involvement of the State in this respect is higher in other countries [Sri Lanka (1.7%), China (2.9%), Brazil (3.9%), South Africa (4.4%)]. In developed countries like USA and UK the involvement of government in health is still higher (UK, 7.8%; USA, 14%). It is thus clear that without substantial increase in public expenditure on health, India would not be in a position to improve its rank on the social dimension of development in spite of high growth rates and growing per capita income.

Table 12.4: Health Development in Comparative Perspective (2017/2018)

Country	Life Expectancy at Birth	Infant Mortality Rate (per 1000 live births)	Maternal Mortality Rate (per 100,000 live deliveries)	Stunting of Children Below 5 (%)	Wasting (Weight for Height) (% Children below 5)	Public Expenditure as % of Total Health Expenditure	Government Expenditure on Health (% of GDP)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
India	69	30	145	38.4	21	25.4	0.9
Bangladesh	72	25	173	36.6	14.3	18.0	0.4
Nepal	70	27	186	35.8	9.7	18.6	1.2
Pakistan	67	57	140	45.0	10.5	27.9	0.8
Sri Lanka	77	6	36	17.3	15.1	43.1	1.7
China	76	7	29	8.1	1.9	58.0	2.9
South Africa	64	29	119	27.4	2.5	53.7	4.4
Brazil	75	13	60	7.1	1.6	33.2	3.9
USA	79	6	19	2.1	0.5	81.9	14.0
UK	81	4	7	-	-	80.2	7.8

Source: World Bank Database on World Development Indicators.

12.6 COMPOSITE INDICES OF DEVELOPMENT

Individual indicators of social and economic dimensions of development discussed in section 12.3 and 12.5 does not enable us to comprehend composite development by way of a single metric like the per capita income. Efforts have therefore been made to combine different socio-economic components into a single value or index so as to arrive at a more comprehensive measure. Some of these measures are: (i) Human Development Index (HDI), (ii) Social Progress Index (SPI), and (iii) World Happiness Index.

12.6.1 Human Development Index (HDI)

The earliest effort for a comprehensive measure of development was made in the form of 'human development index' (HDI) in 1990. The objective of development being to create an enabling environment for people to enjoy long, healthy and creative lives, the HDI defined development as 'a process of enlarging people's choices'. These choices could be seen in three essential aspects viz. (i) leading a long and healthy life, (ii) acquiring knowledge and (iii) having access to resources needed for a decent standard of living. Corresponding to these three aspects, three separate components are selected for the construction of the HDI. These components are: (i) longevity measured in 'life expectancy at birth', (ii) knowledge measured by literacy and (iii) resources for a decent living represented by per capita income. Since 1990, with some modifications, HDI is being calculated for most of the countries. Table 12.5 provides HDI values and ranks for 2019. India with a rank of 129 (from among 189 countries) shows marginally better performance than Bangladesh (135), Nepal (147) and Pakistan (152).

Table 12. 5: Comprehensive Indices of Development

Country	Human Development Index 2019		Social Progress Index 2018		World Happiness 2016-18
	Value	Rank	Score	Rank	Rank
India	0.65	129	56.3	100	140
Bangladesh	0.61	135	52.2	108	125
Nepal	0.58	147	56.1	101	100
Pakistan	0.56	152	49.2	115	67
Sri Lanka	0.78	71	68.0	67	130
China	0.76	85	64.6	87	93
South Africa	0.71	113	-	-	106
Brazil	0.76	79	72.7	49	32
USA	0.92	15	-	-	19
UK	0.92	15	88.7	13	15

It is way down compared to China (85) and Sri Lanka (71). Interestingly, the HDI ranking corresponds to the income performance especially for three out of five

South Asian economies [vide Table 12.1 (PCI within brackets): Sri Lanka (\$4102), India (\$2010) and Bangladesh (\$1698)]. Pakistan's PCI is higher than Nepal but in terms of HDI rank, Nepal's rank (147) is better than that of Pakistan (152).

12.6.2 Social Progress Index (SPI)

Social Progress Index (SPI) is published by an international civil society organisation called 'Social Progress Imperative'. It defines social progress as: the capacity of a society to meet the basic human needs of its citizens. It specifies the achievement of this by establishing the building blocks that allow citizens and communities to enhance and sustain the quality of their lives. It thereby ensures that the conditions necessary for all individuals to reach their full potential is created in a country. The SPI is based on 54 indicators. They encompass three basic aspects viz. basic human needs, foundations of well being and opportunities. The SPI is published regularly since 2014. The SPI for 2018 ranks the countries in our sample as: India (100), Bangladesh (108), Nepal (101), and Pakistan (115). These four countries are at the near bottom of the 146 countries ranked. China (87), Sri Lanka (67), Brazil (49) and UK (13) are way above in this regard.

12.6.3 World Happiness Index (WHI)

In July 2011, the UN General Assembly passed a historic resolution. It invited member countries to measure the happiness of their people and use this to help guide their public policies. Following this, the OECD came out with 'Guidelines for the Measurement of Subjective Well-being'. The first 'World Happiness Report' was brought out in 2012. Based on six indicators (corruption, generosity, years of life, life experience, sense of freedom and GDP per capita), the happiness index is constructed on a scale of 0 to 10. The report for 2016-2018, surveys 156 countries and ranks them (Table 12.5). India with a rank of 140 ends up at the bottom of the ten countries compared here. Pakistan which was a much lower performer in most of the other socio-economic dimensions considered before, emerges on the top of all the six Asian countries in terms of happiness (67). Sri Lanka which was on top of Asia in many aspects, recedes to a much lower happiness ranking (130). Brazil (32), USA (19) and UK (15) are the leading countries ranked higher in this regard. The subject of 'well-being' is, however, a still nascent idea. With further refinement over time, it must be able to sort out the above anomaly.

Check Your Progress 3 [answer within the space given in about 50-100 words]

- 1) Why was 'adult literacy' historically considered for measuring the level of education in a country? What has been the recently reoriented emphasis?

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- 2) What is India's position in respect of 'gross enrolment rate (GER) in secondary education'?

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- 3) Where does India stand on 'mean years of schooling'? In which respect, India's position is better than other countries in the South Asian region?

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- 4) State the two major determinants of a country's health status.

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- 5) How is 'social progress' defined? What is the relative position of India in respect of Social Progress Index?

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12.7 LET US SUM UP

The limitation of PCI as a means for measuring the relative development of countries has led to construction of composite indices like HDI and SPI. The development of these measures has enabled according due importance to the basic factors which matter in creating wealth in a country. In this effort, the social factors of education and health have received due weightage. In the comparative

profile of ten countries made in the unit, the position of India is seen to be just above its three Asian neighbours viz. Nepal, Bangladesh and Pakistan. Substantial increase in public expenditure in social sectors, both education and health, is vitally needed for India to improve its position by improving its rank in its overall development.

12.8 SOME USEFUL REFERENCES

- 1) Dreze, Jean and Amartya Sen (2013). *An Uncertain Glory: India and Its Contradictions*, Allen Lane, Penguin Books, London.
- 2) Nayyar, Deepak (2019). *Resurgent Asia: Diversity in Development*, Oxford University Press, New Delhi.

12.9 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

- 1) PCI does not relate to distribution of income but merely to the total magnitude of income expressed in per capita terms. It is useful differentiating countries into developed-developing and for categorising economies based on their average income level.
- 2) The framework should have representation from all category of countries across the developing-developed divide. It should cover a fairly large proportion of population of the world. The sample of countries chosen is justified since they cover more than 50 percent of global population.
- 3) Population, per capita GDP, long term average annual growth rate in GDP, share of agriculture in total employment and its contribution to GDP.
- 4) China gained a giant leap over India by registering an impressive long term annual average growth rate of 6.8 percent over the period 1961-2011. India, though figured far less impressively in this respect, has managed to catch up with China in this respect in recent times. Sri Lanka's graduation to upper middle income category is notable for its structural shift in terms of lower agriculture employment and agriculture GDP share (7.9 percent).
- 5) Bangladesh for having moved up to 'upper middle income group' and Nepal for having lifted itself up from 'low income' to 'lower middle income' group.
- 6) Structural dimension refers to an impressive shift in lowering the employment and GDP share of a country from its agricultural sector. Sri Lanka is the only country in the sample of 5 South Asian countries to have managed to reduce the employment-GDP share from agriculture to comparable levels with China.

Check Your Progress 2

- 1) Deficits of development refers to prevalence of poverty and unemployment despite rising PCI with growth. It also signifies widening of inequality in the society.
- 2) In case of India, Sri Lanka, China, there is evidence to see that with rising income (GDP), there is reduction in poverty. However, in case of South Africa there is income rise but poverty ratio is also very high (56 percent in 2014).
- 3) It is because of large proportion of employment being informal where disguised unemployment is very high.
- 4) Novel methods are employed by WID to generate data on income comparable between countries. Its trend reveals that inequality in South Asian economies is around 40+ percent for India and Bangladesh and much lower at just above 30 percent for Nepal and Pakistan. It is highest for Sri Lanka and China (both equal to 49 percent).
- 5) Developed countries too have high inequality of 32 percent in UK and 39 percent in USA (in 2018). This compares with that of 33 percent in Nepal and 32 percent in Pakistan (in 2018).

Check Your Progress 3

- 1) Because it was expected to reveal historical neglect or achievement in the educational status of people. The more recent emphasis is on 'access, equity and quality' of education.
- 2) It is bracketed with Bangladesh and Nepal with more than 25 percent of eligible students still staying out of the secondary education system.
- 3) India stands somewhat in the middle of the 10 countries chosen for comparison with its mean years of schooling at 6.5 years. In respect of enrolment in tertiary education, India's position is better than the other four countries of South Asia including South Africa.
- 4) (i) public expenditure as a percentage of total health expenditure and (ii) government expenditure on health expressed as percentage of GDP.
- 5) Social progress is defined as: the capacity of a society to meet the basic human needs of its citizens. On SPI, India ranks just above Bangladesh, Nepal and Pakistan.

UNIT 13 TRADE AND BALANCE OF PAYMENT*

Structure

- 13.0 Objectives
- 13.1 Introduction
- 13.2 Balance of Payment (BoP) Account
 - 13.2.1 Components of BoP Account
 - 13.2.2 BoP Account Deficit or Surplus
 - 13.2.3 Current Account Deficit (CAD)
- 13.3 Liberalisation of Capital Account in India
- 13.4 International Comparative Profile of CAD
 - 13.4.1 CAD and Developing Economies
 - 13.4.2 CAD and Developed Economies
 - 13.4.3 Settlements Account
 - 13.4.4 Factors Influencing Current Account Balance
- 13.5 Let Us Sum Up
- 13.6 Some Useful Books and References for Further Reading
- 13.7 Answers or Hints to Check Your Progress Exercises

13.0 OBJECTIVES

After reading this unit, you will be able to:

- indicate the benefits of trade specifying its three dimensions of measurement;
- define the term ‘balance of payment’ (BoP);
- specify the classificatory framework of a BoP account;
- delineate the concepts of ‘BoP Account Deficit or Surplus’;
- state why high ‘current account deficit’ (CAD) is undesirable for the health of an economy ;
- present an account on the process of ‘liberalisation of capital account’ in India;
- make a comparative profile of CAD between the developed and developing economies of the world;
- highlight the importance of ‘settlement account’ in BoP; and
- enumerate the factors which influence ‘current account balance’ in BoP.

* Ms. Vishakha Goyal, Asst. Professor, Delhi University.

13.1 INTRODUCTION

Even at the time of primitive stages of development, economies were engaging in trade with other countries. Now, most modern economies are engaged in free trade. Such interactions with other economies widen the choice for consumers. Producers can increase their scale of production and find new markets for their goods. International trade, thus, has the potential to facilitate both production and consumption. Countries also get the opportunity to have foreign companies setup their production units in their countries. These transactions create the need to keep a systematic record of all transactions. The account which records all such transactions is called 'balance of payment (BoP) account'. The concept of BoP is central to understanding the international conflicts relating to trade and exchange rate. In the globalised world, foreign trade plays a vital role in the development of any economy. It is, therefore, important to have measures of foreign trade so that a government can take necessary step to steer its economy in the desired direction. The magnitude of foreign trade is calculated in terms of its: (i) volume, (ii) composition and (iii) direction. Volume of trade tells us the size of international transactions. It is measured in value terms and is accounted separately for both exports and imports of a country. Composition of trade refers to the major commodity or sectors in which a country is exporting and importing. Direction of foreign trade is indicative of the economic linkages with rest of the world. It tells us the countries to which India exports its goods and the countries from which it imports. Thus, direction consists of destination of exports and sources of our imports. It reflects the pace of economic development of the country. This is because, as the country begins to trade with a large number of countries, economic development becomes faster.

13.2 BALANCE OF PAYMENT (BoP) ACCOUNT

Foreign trade requires international currency. If a country's exports are high, then the country can accumulate surplus foreign currency reserves. But in case of a developing country having high imports as compared to exports, there is always a deficit of foreign exchange. It is necessary to strive for a balance of international trade to have the surplus required to pay for necessary imports. In order to keep a check on foreign exchange reserves, an accounting statement is prepared giving an exact profile of country's transactions with other countries in a financial year. This is known as the 'balance of payments' (BoP) of a country. It is a systematic record of all economic transactions between the residents of a country and the rest of the world. It comprises of: (i) all receipts on account of goods exported, services rendered and capital received by residents and (ii) all payments made by the residents for goods imported, services received and capital transferred to non-residents or foreigners.

Balance of payment provides the government with the data needed for the formulation of fiscal and monetary policies. For instance, to reduce the nation's borrowing, the government can levy a tax on certain imports. Such a tax contributes to reducing the 'current account deficit' (CAD) of a country. CAD refers to a situation where the total value of a country's imports (M) exceeds the total value of its exports (X) i.e. $(M - X) > 0$ or $(X - M)$ i.e. $CAD < 0$. The current account of the BoP captures the details of exports and services which is important for negotiating the trade policy of a country with its trading partners. Likewise, the Balance of Payment information is also important for firms, investors and

banks even though they might not be involved in international trade and finance. Their interest would be to assess the financial stability of a country.

13.2.1 Components of BoP Account

The classificatory framework of the BoP account comprise of three account heads viz. (i) current account, (ii) capital account and iii) reserve assets account. The current account records all current year transactions of flow of goods and services (exports and imports) during a given financial year. It has two sub-parts viz. 'trade account' which records export and import of 'goods' [called 'balance of trade' (BoT)] and 'transaction of other invisibles' (like financial services, insurance services, shipping services, etc.). The latter (i.e. 'transaction of other invisibles') is thus mainly a record of movement of services [hence called the 'balance of services (BoS) account'] during a financial year. The two, BoT and BoS, together constitute the 'current account' of BoP account. Capital account (in the BoP account) shows receipts of capital and payments between the country and rest of the world. It includes foreign investment flows, external loans, borrowings and other items like loans or donations. A third important component of BoP account is the government's 'official reserve assets' accounts. This comprises gold stock, holdings of convertible foreign currencies and 'special drawings rights' (SDRs). This account acts as a balancing item for current and capital account deficits and hence also serves as the official account on 'foreign exchange reserves'. There will be a decline in this account if the net outflow of foreign exchange is high compared to the net inflow or when the total disbursement on the current and capital accounts exceeds the total receipts. Ideally, the balance on current account and capital account needs to be offset by the 'official reserve assets' account.

13.2.2 BoP Account Deficit or Surplus

A country is said to face a BoP deficit situation when the value of its total imports (of goods, services and investment income i.e. capital inflow) exceeds the value of exports (of goods, services and capital outflow). Conversely, a country will face a surplus of BoP account when the total value of exports of 'goods, services and capital inflow' exceeds the value of imports of 'goods, services and capital outflow'. Formally, in terms of 'national income accounting' identity i.e. in terms of 'aggregate expenditure' and 'aggregate output' this can be written as:

Aggregate Expenditure (AE) = Consumption Expenditure (C) +

Private Investment (I) + Government

Spending (G) + Exports (X) (13.1)

and Aggregate Output (Y) = Consumption (C) + Savings (S) + Taxes (T)

+ Imports (M) (13.2)

The economy is in equilibrium when $AE = Y$. That is:

$$C + I + G + X = C + S + T + M \quad (13.3)$$

$$\text{or, } I + G + X = S + T + M \quad (13.4)$$

$$\text{or, } X - M = (S - I) + (T - G) \quad (13.5)$$

The component $(X - M)$ is the net of exports and imports (i.e. current account deficit), $(S - I)$ is 'savings-investment gap' and $(T - G)$ is the 'budget deficit'. Assuming a balanced budget (i.e. $T = G$), net exports in the economy can be

linked to the savings-investments gap. Hence, a country with a 'current account deficit' (CAD) will have to fund its deficit from international borrowing. We can, therefore, see why 'current account deficit' is the same as the 'BoP deficit'.

13.2.3 Current Account Deficit (CAD)

Ideally, the CAD [i.e. $(X - M)$] should be positive. A negative CAD implies that total imports are higher than total exports. Such a deficit can be financed by foreign investments or debt. This can, however, be problematic if the country is unable to re-pay its debt. In such situations, a country is said to face a 'BoP crisis'. Another way by which CAD can be financed is by external borrowing i.e. either from other countries or financial institutions like IMF. In the long run, however, it is not sustainable to finance consumption with borrowing. This is because countries with large interest payment would often have less investment. For long term growth, it is important to have more investment as current investment fuels future growth.

A widening CAD implies the country will need more foreign currency than domestic currency. An excess demand for foreign currency would, in turn, imply a weaker domestic currency. This could result in cost-push inflation especially if the country's foreign basket comprises more of imported goods. A rising 'trade deficit' could also be indicative of the domestic industries being unable to compete against cheaper imported goods. This might result in loss of jobs as domestic manufacturers might have to shut down their establishments. This could especially be true for infant industries in the trade-deficit country. In such a situation, the trade unions might demand protectionist measures against imports. In view of these factors, it is important to keep the CAD under control.

Check Your Progress 1 [answer within the space given in about 50-100 words]

- 1) What is meant by a 'Balance of Payment Account'?

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- 2) State the three dimensions in terms of which BoP account is measured? In what way they are useful?

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- 3) What is meant by a BoP of a country? In what way is it useful?

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- 4) State the three main 'heads of account' of BoP. In particular, what are the two sub-heads of the 'current account of BoP' and what do they capture?

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- 5) What is 'current account deficit' (CAD)? What does a widening CAD imply?

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13.3 LIBERALISATION OF CAPITAL ACCOUNT IN INDIA

Capital account liberalisation is a process by which a country eventually attains the status of full convertibility of its BoP's 'capital account'. It is ideal to liberalise 'current account' before liberalising 'capital account'. This is because liberalisation of capital account makes an economy susceptible to massive exchange rate fluctuations. Wide speculation in international markets can trigger massive inflow and outflow of capital causing instability in the capital account. Likewise, massive capital inflows will put appreciation pressure on the domestic currency affecting the competitiveness of domestic exports which, in turn, worsens the CAD (current account deficit). Thus, a natural order to follow is to first liberalise the 'current account' and then adopt 'capital account convertibility'.

India's experience of 'capital account liberalisation' needs to be looked at in three phases: (i) 1950-1990, (ii) 1990-92 and (iii) 1992 onwards (post-liberalisation). In the early years of India's independence, there was a focus on industrial development in the public sector. This required massive import of technology and machines (particularly of capital goods) which exerted pressure on BoP account of India. Despite this, India witnessed a surplus in its 'current account' of BoP from 1950 to 1954. During the second five year plan (1956-61), rapid industrialisation through the development of basic and heavy industries were adopted. This led to an unfavourable balance on 'current account' during the decade of the 1960s. India had to seek external assistance by way of loans from the World Bank and IMF. Heavy trade deficits, debt obligations and a sharp fall in foreign exchange reserves led to the first devaluation of the rupee in 1966. In the early 1970s, though exports grew, there was also a large increase in imports leading to continued trade deficits. Despite this, in the year 1973-74, India enjoyed substantial 'current account surplus'. This was largely due to surplus in terms of 'invisible transfers' (e.g. inflow of foreign aid). After 1973, there was a gradual increase in crude oil prices in the international market resulting in a sharp increase

in the total import bill of the country. The export performance continued to suffer by the severe international recession of 1980-83. The repayments to IMF during this period put an added pressure on India's BoP. In spite of significant external assistance, commercial borrowings and non-resident deposits, India's external debt too increased.

By 1990-91, India had witnessed three major developments which contributed to a 'BoP crisis'. Firstly, during the late 1980s, oil prices witnessed a sharp increase. This was followed by the Gulf war which led to further increase in the oil import bill of the country. Secondly, there were many Indian which was a good source of remittances. The gulf war rendered the Indian worked to return home stopping the remittances from Indian workers. Thirdly, USSR, which was a high destination for Indian exporters, witnessed disintegration into many smaller countries. The economy of these newly independent countries themselves faced an economic crisis. This led to a decline in exports to USSR. All these factors led to a dwindling of India's foreign exchange reserves (from a level of Rs. 54800 million at the end of August 1990 to Rs. 16660 million in January 1991 i.e. a steep decline of nearly 70 percent reserves). By June 1991, the level of foreign exchange reserves dropped to such an extent that it was insufficient to finance the necessary imports. As a result, the Indian economy witnessed sharp inflation leading to India experiencing the worst ever 'BOP crisis' since independence.

During the economic reforms initiated in 1991, macro-economic stabilisation measures were introduced to control the crisis. Drastic changes in trade policy, devaluation of the rupee, rupee convertibility, tariffs cuts and import liberalisation were introduced. For the first time, the union budget of 1992-93 made the Indian rupee partially convertible. This was an inevitable move for the integration of Indian economy with the rest of the world. Under this, 60 percent of exchange earnings were convertible in rupees at market determined exchange rate and the remaining 40 percent earnings at the officially determined exchange rate. The term convertibility (of a currency) indicates that it can be freely converted into any other currency. Convertibility thus gives freedom in terms of removal of quantitative restrictions in trade and payments made on 'current account'. It establishes a system where the market determines the exchange rate by a free interplay of demand and supply forces. During 1993-94, the BoP position improved due to growth in exports, fall in international prices of crude oil and the slack in the growth of non-oil imports. During 1994-95, both exports and imports grew significantly (exports by 18.4 percent and imports by 22.9 percent). Due to this, India's 'invisible payments' rose considerably and as a result, India's 'current account deficit' (CAD) also widened. But the total capital flows in 1994-95 were much in excess of financing needs and hence the build-up foreign exchange reserves was good. The surge in exports and imports continued in 1995-96. But the CAD also grew touching 1.7 percent of GDP. The CAD narrowed down to about 0.5 percent GDP in the year 2000-01. It has largely continued to remain low (around 2-3 percent range) since then (e.g. 0.7 percent of GDP in 2016-17 and 1.8 percent of GDP in the first half of 2017-18). Since 2002-03, there was a sharp increase in India's 'invisibles account' due to significant rise in gross receipts and payments. The strong growth in services exports, especially of software and Information Technology (IT) services, and remittances from overseas contributed to this. During the period 2001-08, the 'invisibles receipts' constituted around 45 percent of current account receipts, while invisible payments accounted for around 25 percent of current account payments. The lower order of payments vis-à-vis receipts in the 'invisibles account' contributed to the build-up of significant

surplus accounting to an average growth of nearly 35 percent over the period 2001-08 which fully financed the trade deficit over the corresponding period.

It is considered remarkable that India made these achievements in the face of appreciation of rupee, high interest rates, spiralling oil prices and general economic slowdown in the major trading countries in the world. It is important to note that the rising trend in capital inflows was accompanied by a change in its composition (e.g. services upsurge). Another welcoming feature was the rise in gross FDI (foreign direct investment) inflows. India emerged as the second most favoured FDI destination after China in 2005 and 2006. This led to an overall BoP surplus resulting in an accretion of foreign exchange reserves. Presently, large merchandise trade deficit coexist with a lower CAD because of the surplus on 'services account'.

Check Your Progress 2 [answer within the space given in about 50-100 words]

- 1) Why is it preferable to liberalise 'current account' of BoP before its 'capital account'? What does 'full convertibility' imply?

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- 2) When was the first devaluation of Indian rupee done? What circumstances led to this?

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- 3) State some situations which marked India's continued the situation destabilised on the BoP front during the 1970s and 1980s?

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- 4) What policy changes were introduced during the early years of 1990s to cope with India's worst ever 'BoP crisis' since independence?

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- 5) What factors contributed to result an ease on the BoP front in the early 1990s? What was the level of CAD through 1990s to early 2000s?

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- 6) What factors contributed to a further ease in the BoP situation during the later years of first decade of 2000s?

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13.4 INTERNATIONAL COMPARATIVE PROFILE OF CAD

It is important to understand the linkage between the 'current account deficit' and the development stage of an economy. It is a well-known fact that the LDCs (low developing countries) and the UDCs (under developing countries) need larger funds to import capital goods. This does not mean that a developed country does not import much. As we saw above, CAD (current account deficit) measures a country's saving gap i.e. the excess of investment over savings. This gap is bridged by the net transfer of resources from the rest-of-the-world to the country running the deficit. This implies that higher CAD by itself cannot be bad for an economy so long as it has sufficient flow of foreign funds. However, in a developing country, high CAD can sometimes become an alarming situation. Developing countries need a push-through investment and if it is to a great measure from the rest of the world, it means that it will not be able to sustain financing fresh investments with its own savings. Ultimately, therefore, it comes down to an economy's ability to absorb and service its capital inflows. If the resources can be distributed in such a way as to enhance its ability to repay (through production), a high CAD to GDP ratio could be sustainable. If they cannot, it can become a hindrance for the development path of an economy. Too high a ratio can prove unsustainable in the long run as it happened in East Asian economies (in late 1990s) and in Mexico slightly before (1994). To that extent, low ratio of CAD has its advantages. But, very low ratio carries with it an opportunity cost i.e. of not being able to benefit from resources that could be drawn from outside. This is the reason why every economy wants to control its CAD by which is meant maintaining a healthy or sustainable balance. It is, therefore, important to note that high CAD is not necessarily a hindrance in the economic development of a country.

13.4.1 CAD and Developing Economies

Developing countries usually lack in technology. Due to this reason, they have to depend on imports for technology and machines which accounts for a substantial part of their BoP. Besides importing high amount of capital goods, to stimulate the process of development, developing economies also have to import consumer goods, raw materials and spares. R&D and innovation in the initial stages of development usually remain low and hence they have to import many kinds of services too from developed economies. In such a scenario, total amount of import cannot be matched by export earnings which results in high CAD. In the last few decades, the process of globalisation has given some advantage to developing countries by way of exporting their human resources. This has propelled developing economies from being a debtor economy to a creditor economy. In other words, globalisation has contributed positively to not only get investment but also technical knowledge. For instance, China, by controlling their imports and boosting low cost manufacturing exports, managed to attain a status of 'surplus current account'. In 2017, its current account surplus was 1.3 percent of its GDP which was a decline from 1.8 percent in 2016. This ratio has been steadily falling from a high of 10 percent in 2007. This trend has continued and in 2018 it turned around to become a country with a CAD of 0.4 percent of its GDP. Other examples in this category are Iran and Iraq.

13.4.2 CAD and Developed Economies

Developed countries usually have a strong manufacturing sector. They therefore export technology and machines to developing economies. But they also experience large CAD. For instance, the US had a CAD of 2.3 percent in 2017 which is substantial given its large economic base. Other developed economies with a CAD of around this value (in 2017) are: Turkey (5.6 percent), Argentina (4.9 percent), U. K. (3.7 percent), Egypt (3.4 percent) and Australia (2.7 percent). Conceptually, 'current account surplus' (CSS) is opposite to CAD which is a situation where the value of $(X - M)$ is positive (which is the reverse with a negative sign for CAD). Some examples of developed countries which have high CSS (in 2017) are: Germany, Japan, China, South Korea, Netherland, Taiwan, Switzerland, Singapore, Italy and Thailand. This brings us to an important concept of 'settlements account' of BoP.

13.4.3 Settlements Account

Deficit or surplus in the BoP account is an ever-changing state i.e. it changes from one year to the next. The overall health of BoP, and its impact on a country, can be measured by the 'settlements account' of BoP (which is also called as 'the official reserve assets account'). The 'settlements account' measures the change in nation's position of 'liquid and non-liquid liabilities' and thereby the change in a nation's official 'reserve assets' during the year. The official 'reserve assets' of a country include its gold stock, holdings from its convertible foreign currencies and 'special drawing rights' (SDRs). It shows transactions in a country's net official reserve assets.

In India, foreign exchange reserves denote the foreign assets held or controlled by the Reserve Bank of India. The reserves are made up of gold or a specific currency. They can also be special drawing rights and marketable securities denominated in foreign currencies like treasury bills, government bonds, corporate bonds and equities and foreign currency loans. In terms of the official 'reserve assets' (in 2018), China held the number one position followed by Japan,

Switzerland, Saudi Arabia, Taiwan, Russia, Hong Kong, India, South Korea and Brazil. The countries listed here being in the descending order of the magnitude of 'reserve assets' held, it shows that for any particular year the relative health of an economy depends also on its 'built reserves' rather than on the current account of the BoP alone. It shows the resilience or the stability of a country's currency to attract capital flows to fund its CAD with the country's growth prospects seen as good. In other words, higher 'reserve assets' are reflective of an investment environment of a country whose financial markets are not prone to frequent speculative attacks. In such an economic climate, foreign investment (FDI in particular) contributes to augmenting the export capacities of the economy. In the long run, it helps in narrowing the CAD to more sustainable levels.

13.4.4 Factors Influencing Current Account Balance

Current account imbalances arise for a number of reasons. Sharp commodity price swings at international level is one of the major factors. For instance, there has been a sharp increase in crude oil prices over the last decade. This particular feature in the global prices of crude oil has the potential to affect the spending pattern of most of the countries. Another factor is that a country may begin to serve as a major hub for foreign firms in manufactures while its own population may lack the earning capacity to consume imports on a scale sufficient to balance-out its rising income from surging exports (e.g. China). This factor becomes stronger with free trade treaties. A third factor is when a country suffers from protracted domestic demand stagnation by an excessive reliance on exports for its growth (e.g. Japan and Germany). Finally, current account imbalances might also result from the loss of competitiveness at the national level. International tensions between countries also affect the 'terms of trade' (ToT).

Check Your Progress 3 [answer within the space given in about 50-100 words]

- 1) Is it always a hindrance for an economy to have higher CAD? Why?
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- 2) In what way China's case is illustrative on the relative merits of high/low CAD? What empirical evidence can you cite in support of this context?
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- 3) How has globalisation proved particularly beneficial for developing economies?

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- 4) What is meant by 'settlements account'? How is this important?

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- 5) State the factors which affect 'current account balances'?

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13.5 LET US SUM UP

International trade (i.e. trade between countries) is important for reaping the benefits of comparative advantage. While both exports and imports are equally important, it is necessary to have a country's exports on the higher side as compared to its total imports. If this could be achieved, it leaves a country in a state of 'current account surplus'; else, in a state of CAD (current account deficit). A system of systematically recording all transactions of exports and imports of a country, with countries in the rest of the world, is what is referred to as BoP account. By focused policies, it is possible to convert the status of a country from a CAD country to a country with CSS (current account surplus). Given that it is a year-to-year changing status, it is not necessarily bad to be even in a state of substantial CAD. What is important is to have enough capital flows required to finance a country's debt or international payment obligations. Against this backdrop, the unit discusses many important concepts like BoP, BoP account, components of BoP (viz. current account, capital account and reserve assets account), CAD, CSS and settlements account. Besides drawing a comparative profile of CAD and CSS of many countries vis-à-vis India, the unit indicates the various factors responsible for causing 'current account imbalance'.

13.6 SOME USEFUL BOOKS AND REFERENCES FOR FURTHER READING

- 1) Basu, Kaushik (ed.) (2008). *The Oxford Companion to Economics in India*, OUP, New Delhi.
- 2) Basu, Kaushik and Annemie Maertens (eds.) (2011). *The New Oxford Companion to Economics in India*, OUP, New Delhi.
- 3) Ratha, D, S Mohapatra and Z Xu (2008). *Outlook for Remittances 2008-10*, Development Prospects Group, Migration and Remittances Team, World Bank.
- 4) Suparna Karmakar, Rajiv Kumar and Bibek Debroy (eds.) (2008). *India's Liberalisation Experience*, Sage, New Delhi.

13.7 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

- 1) It is a systematic record of all transaction on exports and imports of a country to other countries.
- 2) Volume, composition and direction. Volume is measured in 'value terms' and indicates the size of international transactions. Composition refers to the commodity or sectors involved in exports and imports. Direction indicates economic linkage with other countries of the world. It consists of destination of a country's exports and source of its imports.
- 3) BoP is an accounting statement giving an exact position on account of exports and imports of a country between the residents of the country and the rest of the world. It is useful to know a country's position on its 'foreign exchange reserves'. For the government, it is useful to formulate its monetary and fiscal policy. It is also useful as an indicator of the health of an economy.
- 4) The three main heads of account of BoP are: current account, capital account and reserve assets account. The two sub-heads of current account are: BoT and BoS i.e. 'balance of trade' and 'balance of services'. BoT and BoS respectively captures the record of export and import of 'goods' and 'services' respectively. The 'current account of BoP' = BoT + BoS.
- 5) CAD refers to the gap between total exports and total imports. The term deficit implies that it is happening the other way round i.e. instead of exports being higher than imports, it is the imports which is exceeding the exports. The gap or deficit is expressed with a 'negative' sign which needs to be balanced by borrowing or debt. A widening CAD implies a higher negative value and need for more borrowing.

Check Your Progress 2

- 1) Liberalisation of capital account makes an economy susceptible to massive exchange rate fluctuations. Wide speculation in international markets can trigger massive inflow and outflow of capital causing instability in the capital account. It is therefore prudent to first liberalise 'current account' and

then gradually adopt 'capital account convertibility'. Full convertibility implies free convertibility on both the 'current' and the 'capital' accounts of BoP.

- 2) In 1966. Heavy trade deficits, debt obligations and a sharp fall in foreign exchange reserves led to this.
- 3) Gradual increase in crude oil prices in international market resulting in a sharp increase in the total import bill after 1973, severe international recession of 1980-83, repayments to IMF, sharp increases in oil prices during the late 1980s followed by gulf war, disintegration of USSR resulting in lowered exports to these newly formed countries, etc.
- 4) Changes in trade policy, devaluation of rupee, rupee convertibility, tariffs cuts, import liberalisation, partial convertibility of rupee, etc.
- 5) Growth in exports, fall in international prices of crude oil and the slack in the growth of non-oil imports. In 1995-96, the CAD was 1.7 percent of India's GDP. By 2000-01, CAD further slid to 0.5 percent of GDP.
- 6) Sharp increase in India's 'invisibles account' due to significant rise in gross receipts and payments since 2002-03, strong growth in services exports, especially of software and Information Technology (IT) services, and remittances from overseas.

Check Your Progress 3

- 1) No. Economies might be able to sustain servicing of capital inflows provided the financial inflows are productively channelled. If the economic climate is managed healthily, then investments made from such inflows generates domestic incomes which helps in sustaining the economy to service its inflow of finance.
- 2) China's is a unique case where from a status of a very high level of CAD, it has managed to transform itself to a country with CSS in recent years. This it has managed with controlled imports and steady boost of its 'low end manufactured goods' export. In empirical terms it has managed its CAD of nearly 10 percent level to gradually go down to – 0.4 percent over the period 2007-2018.
- 3) Globalisation effectively shifts investment from a capital surplus country to a capital deficient (but potentially economically rich) countries. Developing countries are characteristically rich in cheap unskilled labour, rich skilled workforce, specific types of raw materials and natural resources. They typically lack the technology (which comes with huge investment) needed to harness their otherwise rich human and material resources. Viewed from this angle, the experience of many developing countries over the last 3-4 decades testifies for the beneficial aspects of globalisation.
- 4) While the actual CAD i.e. $(X - M)$ can be positive or negative (deficit if negative and surplus if it is positive, its actual impact on the economy is determined by the country's 'settlements account'. The 'settlements account' is a measure of the change in a nation's position of 'liquid and non-liquid liabilities'. Thus, while $(X - M)$ takes only the liquid assets, the 'settlements account' includes the value of non-liquid assets like "gold stock, holdings from convertible foreign currencies and 'special drawing rights' (SDRs)". For any particular year, the relative health of an economy also depends on its

‘built reserves’ rather than on the current account of the BoP alone. The importance of the ‘settlements account’ is indicative from the fact that it reflects the resilience (or the stability) of a country’s currency to attract capital flows to fund their CAD (with the country’s growth prospects considered good).

- 5) Sharp commodity price swings at international level, large part of a country’s domestic population lacking in purchasing power needed to consume imports (on a scale sufficient to balance-out its rising income from surging exports – a factor which becomes stronger with free trade), domestic demand stagnation (on account of an excessive reliance on exports for growth), loss of competitiveness at the national and international levels and international tension between countries.



UNIT 14 GOVERNANCE AND INSTITUTIONS *

Structure

- 14.0 Objectives
- 14.1 Introduction
- 14.2 Government and Governance
 - 14.2.1 Types of Government
 - 14.2.2 Government and Development
 - 14.2.3 Governance
 - 14.2.4 Good Governance
- 14.3 Constituents of Governance
 - 14.3.1 Economic Governance
 - 14.3.2 Institutions for Governance
- 14.4 Governance Indicators
- 14.5 Let Us Sum Up
- 14.6 Some Useful Books and References for Further Reading
- 14.7 Answers or Hints to Check Your Progress Exercises

14.0 OBJECTIVES

After reading this unit, you will be able to:

- outline the features of the broad types of government;
- distinguish between government and governance;
- delineate the relationship between type of government and development;
- differentiate between ‘governance’ and ‘good governance’;
- highlight the two important constituents of governance differentiating it for its economic and institutional importance;
- discuss the important governance indicators with an appraisal of their significance for development; and
- describe in brief India’s relative position in terms of quality of governance institutions with those of its neighbouring economies.

14.1 INTRODUCTION

The use of the concept of governance, and institutions, in development studies is of a relatively recent origin. Hence, there is as yet no universally accepted definition of governance or institutions. In light of this, the literature on the

subject is confined to some research studies and reports of multilateral organisations like the WB (World Bank) and the UNDP (United Nations Development Programme).

Ever since the evolution of Development Economics in the immediate post-Second World War period, one of the important subjects of debate has been the role of 'state' in development. This is in contrast with the role of 'market' in development as made in the mainstream economics. During the 'Cold War' period, there was a political divide between the Socialist and the Capitalist blocks. The development debate then assumed an ideological undertone in the form of 'state versus market'. In the 1960s, the rapid strides in growth achieved in Japan and South Korea were seen as driven by the initiatives of the state. These states had come to be characterised as 'developmental state'. Such key features of a 'developmental state' were later applied to other East and South-East Asian economies like Hong Kong, Singapore and Taiwan. There were other countries like India where state played a vital role but with very low growth rates. By the late-1980s, with the disintegration of the Soviet Union and the end of Cold War, the slow growth in state-led economies like India was attributed to 'state-failure'. This turned the debate on development towards 'good governance' to facilitate market-driven growth. By early 1990s, Western governments and aid institutions made 'governance' a key condition for providing economic aid. With it there was a distinct turn towards research on 'governance issues and institutions' in development. More recently, the UNESCAP (2017) report observed that: 'the quality of governance and the effectiveness of public institutions are critical factors that contribute to the process of development'.

14.2 GOVERNMENT AND GOVERNANCE

In a literal sense, the two terms 'government' and 'governance' are used interchangeably. But with the growing use of the term governance in its institutional dimension, government is differentiated for its political stance and is seen for the manner in which authority (i.e. legitimate power) is exercised. While power is the ability to influence the behaviour of others, authority is the right to do so. Therefore, government is an authority in a country to exercise legitimate power. The terms government and state are often used interchangeably.

14.2.1 Types of Government

Governments are broadly classified into three types viz. monarchy, dictatorship and democracy. Monarchy is the traditional form of inheritance of authority by a king or ruler to exercise legitimate power for ruling a country. This is a rare exception in the present times. Hence, dictatorship and democracy, in their various hues, are the two widely prevalent forms of government across the countries at present.

Dictatorship is an authoritarian regime defined as a system in which the concentration of power lies within a few hands. In its worst form, there is a single individual-centred dictatorship. The strategies that dictators use in order to be in

power include: use of force, suspension of civil liberties and denial of voice or freedom to people, self-regulated constitutional process, patronage, propaganda (which are but fascist tendencies), etc. Most of the dictatorships are either backed by the military or are direct military regimes with suspended rights of representation by the people.

Democracy, is a form of government, marked for a shift of legitimate power to people through representative governments. The shift of legitimate power to democratic rule has a long history and is depicted in terms of three 'waves of democracy'. The first wave was the 'Glorious Revolution of 1688' in England with the monarchy conceding more power to 'parliament, free elections and freedom of speech'. The 'second wave' of democracy, also a shift from monarchy to democracy, was seen in the 'French Revolution of 1789' with an emphasis on 'liberty, equality and fraternity'. Though there is a certain ideological bias, the disintegration of Soviet Union and the fall of socialist regimes in Southern Europe by the late 1980s, is depicted as a 'third wave of democracy'. This third wave marks a shift from not only authoritarian regimes to democracies but also a shift from 'state-driven economies' to 'market facilitating states'. It is this notion of the democratic state as a facilitator state that brought 'governance' to the centre stage of development debate. In terms of the types of governments across countries in the world, though there is a widespread belief that democracy is the dominant form of government across the countries, the reality is otherwise.

Through a complex exercise, the Intelligence Unit of 'The Economist' publishes a 'Democracy Index' of more than 160 countries since 2006. The Democracy Index is based on five categories of indicators viz. (i) electoral process and pluralism, (ii) the functioning of government, (iii) political participation, (iv) political culture and (v) civil liberties. Based on its scores on a range of indicators within these categories, each country is classified as one of the four types of governments viz. full democracy, flawed democracy, hybrid regime or authoritarian regime. The latest Democracy Index for 2019 shows that only 22 countries (representing about as little as 6 percent of world's population) are 'full democracies'. As many as 54 countries (covering another 36 percent of world's population) are 'authoritarian regimes'. The democracy index is a composite score assessed for all the five indicators above and is expressed on a scale of zero to ten where a country scoring more than 8 is regarded as a full democracy. India, with a score of 6.9, and with a rank of 51 out of 167 countries, belongs to the category of 'flawed democracies'. This category shows that these countries suffer from several democratic deficiencies. Table 14.1 shows a comparative picture of six neighbouring South Asian countries to India in this regard. Their overall rank in the world is: India (51), Sri Lanka (69), Bangladesh (80), Nepal (92), Pakistan (108) and China (153). In particular, China figures as an 'authoritarian regime. In contrast, Scandinavian countries like Norway (1) and Sweden (3) are on the top with near perfection as 'full democracies'.

Table 14.1: Democracy Index 2019

Country	Electoral Process and Pluralism	Functioning of Government	Political Participation	Political Culture	Civil Liberties	Overall Score	Rank
India	8.7	6.8	6.7	5.6	6.8	6.9	51
Bangladesh	7.8	6.1	6.1	4.4	5.0	5.9	80
Nepal	4.8	5.4	5.0	5.6	5.6	5.3	92
Pakistan	6.1	5.7	2.2	2.5	4.7	4.3	108
Sri Lanka	7.0	6.1	5.6	6.3	6.5	6.3	69
China	0.0	4.3	3.3	2.5	1.2	2.3	153
Norway	10.0	9.6	10.0	10.0	9.7	9.9	1
Sweden	9.6	9.6	8.3	10.0	9.4	9.4	3

Note: Score: 8 to 10 = Full Democracy, 6 to 8 = Flawed Democracy, 4 to 6 = Hybrid, 0 to 4 = Authoritarian

Source: The Economist Intelligence Unit, 2020.

14.2.2 Government and Development

Does the type of government make a difference to development? The answer is: 'yes'. Economic growth is expected to be sub-optimal under dictatorship for the following reasons: First, in order to safeguard their roles, dictators use much of the revenues expropriated from the public for expenditure on military, police and secret service with lower priority to social development like health, education and social security. Second, fear of expropriation discourages the investors, new entrants and innovators in making investment. Third, Authoritarian regimes perpetuate inequalities because of their dependence on the support of the rich and treat the poor as a threat. Most of the strategies of the authoritarian regimes are socially undesirable. In view of this, over the years in the 20th Century, most of the authoritarian regimes have yielded place to democratic transition in response to strong and sustained peoples mobilisation against them. Yet, even in 2019, there are as many as 54 countries which are categorised as 'authoritarian regimes' across the world.

In contrast to dictatorship, democracy as a representative government endows power to the ruled. Democratic institutions like (i) elected legislature, (ii) independent judiciary and (iii) respect for law, individual rights and freedom, encourage enterprise and innovation. An economy will be able to reap all potential gains from investment, and from long term transactions, only if it has a government that is believed to be both strong enough to last (i.e. stable) and inhibited from violating individual rights. Thus, the conditions needed to have individual rights for maximum economic development are exactly the same conditions as are needed to have a lasting or stable democracy. There is a criticism in some quarters that democracy generates redistributive demands that undermine

investment priority and affect growth. However, this criticism does carry much validity since growth rates in many democratic countries (including India) are much higher than many authoritarian countries. As Amartya Sen (1999) points out, democracy matters for governing large complex societies such as India for two reasons: (i) democracy protects and manages pluralism (creating political underpinnings of recognition in heterogeneous and diverse societies) which, in turn, nurtures diverse enterprise and (ii) democracy favours demand for better living standards which promotes a fair distribution of 'gains of growth'.

In light of the above, there is a growing mobilisation in more and more countries for democracy. With it, there has been an increasing emphasis on governance to overcome the 'deficits of democracy'. Let us, therefore, turn to analyse the term 'governance' in some detail.

14.2.3 Governance

The term 'governance' is differentiated from government. The emergence of the term 'governance' can be traced to a disaffection with the state dominated models of economic development that were prevalent in the 1950s through 1970s. The term 'governance' subsumes institutions of state and beyond. In this context, the term 'new institutional approach' lays particular emphasis on 'non-state institutions'. The term 'governance' is defined in various ways by different organisations. Two comprehensive definitions, one by the World Bank and the other by the United Nations Development Programme (UNDP) are presented here.

World Bank (1994): The WB defines 'governance' as the manner in which power is exercised in the management of a country's economic and social resources. There are three distinct aspects of governance: (i) the form of political regime; (ii) the process by which authority is exercised in the management of a country's economic and social resources for development; and (iii) the capacity of government to design, formulate, and implement policies and discharge functions.

UNDP (1997): The UNDP defines 'governance' as the exercise of economic, political and administrative authority to manage a country's affairs at all levels. It comprises mechanisms, processes and institutions through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences.

These definitions, particularly the one by UNDP, are the ones that dominate the debates and analysis of governance. As such, it is clear that governance refers to a much wider ambit than government. First, these definitions capture various units of governance that are not mere instruments of the state or government. Second, they show that governance is embedded-in and interwoven-with state and civil society interactions. Hence, governance is that part of the public realm which encompasses both the government and the civil society. Third, both the definitions include political dimensions with an implicit reference to 'democratic accountability'. In other words, it deals not only with how power is exercised but also how power is acquired. These definitions are thus in contrast with apolitical definition of Fukuyama (2013) for whom governance is rather about 'a government's ability to make and enforce rules, and deliver services, regardless of whether that government is democratic or not'.

14.2.4 Good Governance

Good governance has an aspirational dimension. It reflects a limited scope compared to the comprehensive definitions referred above. Good governance, among other things, is 'participatory, transparent and accountable'. It is therefore effective and equitable in promoting the 'rule of law'. Good governance ensures 'political, social and economic priorities' based on a broad consensus in society in which the voices of the poorest and the most vulnerable are also heard in decision-making over allocation of development resources. According to the World Bank, policy makers, civil society groups, aid donors and scholars around the world increasingly agree that good governance matters for development. This growing consensus has emerged from a proliferation of empirical measures of institutional quality, investment climate and the accompanying research showing the strong impact of good governance on development.

Check Your Progress 1 [answer within the space given in about 50-100 words]

- 1) Distinguish between Government and Governance.

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- 2) In terms of the overall 'democracy index', what is the relative position of India with reference to its neighbouring countries?

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- 3) State the criticism against democracy. Do you think that the criticism is merited?

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- 4) Bring out the essential constituents of the term 'governance'.

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- 5) In what way 'good governance' is different from 'governance'?

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14.3 CONSTITUENTS OF GOVERNANCE

Within the analysis of the role of governance, there is a reference to two important constituents of governance viz. 'economic governance' and 'institutions for governance'. These two are important for the larger governance analysis. They can be, therefore, considered as sub-sets of governance as follows.

14.3.1 Economic Governance

'Economic governance' relates to the functioning of markets and economic activity. It refers to the structure and functioning of legal and social institutions to support economic activities and transactions. Avinash Dixit (2009) uses the term 'good governance' in the context of the economy to point out that 'good governance' is needed to secure three essential pre-requisites for a well functioning market economy. First, security of property rights, without which individuals will lack the incentives to save and invest. Second, enforcement of contracts which are necessary to assure that the gains accruing from economic transactions reaches all participants. Without guarantee of enforcement, people would fear to enter into contracts and transactions would not take place. Third, collective action is needed to provide adequate provision of public goods through which much of private economic activity takes place. Equally important is control of 'public bads' like crime and violence which adversely affect incentives for private economic activity.

14.3.2 Institutions for Governance

The emergence of 'new institutional economics' (vide the 'new institutional approach' referred to in 14.2.3 above) is as much in the context of 'state-failure' as of 'market failure'. It is argued that differences in growth and development of countries is not merely because of resource differences (i.e. differences in physical capital, human capital and technology) which are but only proximate causes. This is to say that 'Institutions' are the fundamental cause for differences in economic

growth and development. According to a leading light of the New Institutional School [viz. D. North (1990)], 'Institutions are the rules of the game in a society'. In other words, they are the humanly designed constraints to shape human interactions. From this view point, there are three important features of institutions viz. (i) 'humanly devised' (in contrast with others like geographic factors outside human control), (ii) 'rules of the game' (which set constraints on human behaviour) and (iii) their major effect through incentives.

The emphasis of the new institutional school is on 'free markets' and 'protection of private property rights'. Both these are identified as essential requirements for economic development. Critics point out that belief in free markets, with limited role of state, is a major limitation of the institutional approach. They argue that the new institutional approach suffers from a poor understanding of changes in the institutions themselves. This raises the issue of the link between the 'New Institutional approach' and the 'emphasis on governance'. The implicit relation is to be seen in terms of the role of non-state institutions in the development process and in the emphasis on protection of property rights. Analysis of governance issues is therefore much broader encompassing not only property rights and freedom of enterprise but also the implicit normative political bias for democracy. In other words, 'institutions for governance' encompass much larger dimensions.

Check Your Progress 2 [answer within the space given in about 50-100 words]

- 1) What does the term 'economic governance' relate to?

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- 2) According to Dixit (2009), what are the three essential things needed to ensure 'good governance'?

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- 3) What is meant by the term 'institutions for governance'.

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14.4 GOVERNANCE INDICATORS

Broadly, there are two types of measures of governance. One is a set of 'objective measures' and the other 'subjective measures'. The objective indicators of governance measure mainly the state of a political institution (democracy, dictatorship), the type of institutional regime, the occurrence of political instability and violence, and the existence of executive constraints (checks and balances). Data sources for these measures are the POLITY database and the 'Democracy Index' by The Economist Intelligence Unit. The major drawback of these objective measures are that they provide a narrow perspective of governance without providing information on the quality of institutions critical for assessing governance.

There is an alternative to the above objective measures by way of subjective measures of governance which are based on expert opinions and perception surveys. It draws on the database of the 'Worldwide Governance Indicators' (WGI) jointly maintained by the Brookings Institution and the World Bank. The WGI approaches governance from the dimension of 'traditions and institutions by which authority in a country is exercised'. Thus defined, governance includes three major dimensions viz. (a) the process by which governments are selected, monitored and replaced; (b) the capacity of the government to effectively formulate and implement sound policies; and (c) the respect of citizens and the state for the institutions that govern economic and social interactions among them. The database of WGI provides some composite indicators of governance. These relate to: (i) voice and accountability (VA), (ii) political stability and absence of violence/terrorism (PV), (iii) government effectiveness (GE), (iv) regulatory quality (RQ) and (v) control of corruption (CC). The subsequent part of this section analyses the performance of India in terms of each of these five 'Governance Indicators' (Table 14.2), in a comparative perspective, using the latest scores (or ranks) for the year 2019 based on the WGI database. The WGI data used here is in the form of percentile i.e. with 0 to 100 range: zero indicating the worst and 100 the best.

Voice and Accountability (VA) indicates the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association and a free media. India with the provision of freedom of speech as a fundamental right in its Constitution, maintains a relatively high profile in this respect (60.1) compared to its neighbouring countries. Yet, it is nowhere near the top scorers like Norway (100), Denmark (98) or Sweden (97.5). The indicator on 'political stability and absence of violence/terrorism' captures the perception on the likelihood that the government will be destabilised or overthrown by unconstitutional or violent means, including politically motivated violence and terrorism. The score of India on this front (14.8) puts the region in a very poor light of stability not only in comparison with high scoring countries like Norway (90.5) or Sweden (80.5) but even compared to Nepal (23.2) and Sri Lanka (40.5). The indicator on 'government effectiveness' captures perceptions of the quality of public services, the quality of civil service and the degree of its independence from political pressures. It also reflects the quality of policy formulation and implementation and the credibility of the government's commitment to such policies. Of the five governance indicators analysed here,

India's highest score (63.9) is in the case of 'government effectiveness'. China has a slightly better standing in this regard (69.7). Other South Asian neighbours have a much lower ranking in this regard. But the exemplars again are the Scandinavian countries with a score of more than 96 (led by Finland with 99).

Table 14.2: Comparative Profile of Select Economies by Governance Indicators

Governance Indicator	India	Bangladesh	Nepal	Pakistan	Sri Lanka	China
VA	60.1	27.6	39.4	25.6	46.8	8.9
PV	14.8	13.8	23.2	3.3	40.5	36.7
GE	63.9	21.6	16.8	26.9	45.2	69.7
RQ	55.3	28.4	33.7	27.9	55.8	48.1
CC (WGI)	49.5	16.8	27.4	23.6	43.3	45.7
CPI (TI)	41 (80)	26 (146)	34 (113)	32 (120)	38 (93)	41 (80)

Source: WGI except for 'corruption index' for which scores/ranking from two sources are indicated.

Note: Figures within parentheses refer to rank of the country (out of 180 countries surveyed) for the CPI by Transparency International (TI).

'Regulatory Quality' (RQ) is another important indicator reflecting on the capacity of government. It captures the perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. The indicator shows that most of the developing and lower-middle level countries suffer from a relatively poor regulatory quality. India, China and Sri Lanka with a score in the range of 48-56 are better than Bangladesh, Pakistan and Nepal. The weakness in the regulatory capacity of the state over private sector could act as a source for regulatory capture, corruption and inequality.

As we saw before in Sub-section 14.2.1, both India and Sri Lanka were bracketed as 'flawed democracies', while Bangladesh, Nepal and Pakistan ended up still lower as 'hybrid regimes'. Here we see that similar rankings are there for these countries for the indicator on 'rule of law'. This is reflective of the close association between the two dimensions of government and governance. China's rule of law situation seems relatively better than its depiction as an authoritarian regime.

Control of Corruption (CC): CC is another governance indicator closely related to regulatory quality. Of late, across the globe (regardless of whether a country is developed or underdeveloped, whether a democracy or authoritarian) two issues that have been the cause of widespread discontentment and protests are corruption and inequality. Corruption is a much severe governance flaw as it could accentuate inequality. Besides, corruption seriously undermines development by increasing the 'cost of doing business'. It discourages investment and reduces economic growth leading to higher inequality and political instability. Corruption has a disproportionate impact on the poor and the most vulnerable by distorting

prices. It increases costs and reduces access to public services like health and education. Corruption erodes trust in government and undermines social contract. Corruption comes in different forms. For instance, corruption could unfairly determine the winners of government contracts, with awards favouring friends or relatives of government officials. Or, it may lead to regulatory capture with far reaching effect on the policy formulation and implementation with adverse consequences on overall economic development. Therefore, tackling all forms of corruption is critical for achieving progress and sustainable change.

Given the importance of controlling corruption due to the factors mentioned above, there have been several agencies, besides WGI, which measures the extent of corruption in countries. Here, we present indicators published by two sources viz. the WGI and the 'Corruption Perceptions Index' by the Transparency International (TI). The survey by the latter (TI) covers 180 countries which is larger than that covered by the CC of WB/Brookings. Corruption Control (CC) indicator of WGI captures perceptions on the extent to which public power is exercised for private gain (including both petty and grand forms of corruption) as well as 'capture of the state' by elites and private interests. As in the case of other WGI indicators, even in the 'Control of Corruption', the standing of India and Sri Lanka is poor but better than that of other neighbours like Bangladesh, Nepal and Pakistan. China, except in 'voice and accountability', sails with India and Sri Lanka in all indicators including CC. Finland with a score of 100 is marked for 'zero corruption'!

The Corruption Perceptions Index (CPI) of the Transparency International (TI) aggregates data from a number of different sources that provide perceptions by business persons and country experts on the level of corruption in the public sector. The CPI 2019 uses 13 different data sources from 12 different institutions to capture the perceptions on corruption (with a reference period of past two years). The data are standardised for a score in the scale of 0 to 100 (the higher the score lesser the corruption). The TI data too confirms the relative corruption position of India and its neighbours though with a relatively lower score (i.e. 49.5 in case of WGI and 41 in case of TI). While India is relatively better in voice and accountability and rule of law, China out-performs India in 'government effectiveness' and 'political stability'. But they are precisely at the same level on corruption index (with a score of exact 80 for both as per the TI).

Critics point out to certain limitations of WGI database. First, it uses several different databases to derive the indicators of WGI. These perception surveys differ in their samples. Moreover, as over a period of time, the sources and methods change, inter-country comparisons over a period is difficult. However, WGI source is transparent in pointing out their methodology (like the 'latent variable' approach used to make corrections to the data). Second, it is pointed out that there is a difference between perceptions of a phenomenon and its actual measurement. This is to say that perceptions differ with the position of those in the sample though appropriate adjustments are made depending on experience from earlier surveys. A third point of criticism is that since there is no universal definition of 'governance' it cannot be measured directly. But it is a common practice to use proxy variables when measuring a phenomena which cannot be

observed directly. Hence, methodologically, WGI, despite these criticisms, has retained its significance.

Check Your Progress 3 [answer within the space given in about 50-100 words]

- 1) What are the major factors to which the indices provided by the WGI database relates?

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- 2) In which respect India scores better than its neighbouring countries? What does it indicate?

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- 3) What does the governance indicator of 'government effectiveness' (GE) suggests and how does India and China compare on this front?

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- 4) State the two agencies which measure corruption as a factor of governance indicator.

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5) What are the criticisms made against the WGI database?

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14.5 LET US SUM UP

Governments are classified into three types of which the democratic form is widely acknowledged to be pro-development. Nevertheless, although more and more countries are becoming democratic, still, not only there are many countries under authoritarian regime, but many democratic countries (including India) are categorised as ‘flawed democracy’ - a term signifying deficiencies on several front. The term ‘governance’ encompasses multiple dimensions like form of political regime, process by which authority is exercised, capacity to design and implement policies, etc. The term ‘governance’ signifies the harmonious coexistence of both government and civil society for ‘democratic accountability’. The term ‘governance’ is distinguished from the term ‘good governance’ which ensures a ‘consensus based decision making’ in which the voices of the poorest and most vulnerable are also duly taken into account. In view of the strong linkages of good governance with the development indicators, many ‘governance indicators’ have been developed in recent years. Based on this, countries are ranked. In particular, in respect of the ‘corruption perception index’ (CPI), India and China are at equal level though India fares better in comparison to China in respect of the ‘voice and accountability index’.

14.6 SOME USEFUL BOOKS AND REFERENCES FOR FURTHER READING

- 1) UN (2016). Governance and Institutions, Chapter VI, in World Economic and Social Survey 2014/2015, New York.
- 2) World Bank (1997). Governance and sustainable Development, UNDP, New York.

14.7 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

- 1) Government is an authority in a country to exercise legitimate power. Governance refers to a notion of democratic state in which the ‘state’ is a facilitator of markets to function efficiently.
- 2) India, though is also yet a flawed democracy, fares better than its 5 neighbours (rank within brackets) as follows: India (51), Sri Lanka (69), Bangla Desh (80), Nepal (92), Pakistan (108) and China (153).

- 3) A criticism against democracy is on the ground that it 'generates redistributive demands that undermines investment priority and affect growth'. The criticism is not merited because 'growth rates in many democratic countries (including India) are much higher than many authoritarian countries'.
- 4) 'Governance' refers to a notion of democratic state. The term subsumes institutions of state and beyond. The latter includes non-state institutions like the civil society. Governance, thus, refers to a much wider ambit than a government. There is an implicit reference to 'democratic accountability' in the term governance.
- 5) Good governance is 'participatory, transparent and accountable'. It takes into account the voices of the poorest and the most vulnerable including under it the principles of 'inclusive growth'.

Check Your Progress 2

- 1) It refers to the structure and functioning of legal and social institutions to support economic activities and transactions.
- 2) Security of property rights, institutions to ensure the enforcement of contracts and collective action for the effective provision of public goods.
- 3) It is much broader than mere 'property rights' and 'freedom of enterprise'. It includes a political bias for democracy.

Check Your Progress 3

- 1) It relates to: (i) voice and accountability (VA), (ii) political stability and absence of violence/terrorism (PV), (iii) government effectiveness (GE), (iv) regulatory quality (RQ) and (v) control of corruption (CC).
- 2) Voice and Accountability. It indicates the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association and a free media.
- 3) It captures perception on quality of public services and its independence from political pressures. It also captures the credibility of the government in its commitment to policy formulation and implementation. China scores marginally higher (69.7) than India (63.9) in this respect.
- 4) CC of WGI (by Brookings and WB) and CPI by Transparency International.
- 5) It uses different databases, the surveys differ in their sample characteristics making inter-country comparison difficult, etc.

GLOSSARY

Agglomeration Effect	It means cluster of population and economic activities. In economics, agglomeration means the phenomenon of locating firms close to one another. At its core, agglomeration's underlying theory is that businesses and resources can take advantage of a number of efficiencies by being located close to one another. There are actually two major categories of agglomeration: urbanisation economies and localisation economies. Urbanisation economics means benefits that firms in a number of different industries receive from population and infrastructure clusters. A great example of this is a shopping mall. Localisation economics means firms in the same industry get benefits from being located close to each other.
Balance of Payments	It summarises all transactions of country's individuals and government with rest of the world. These transactions consist of <u>imports</u> and <u>exports</u> of goods, services and capital, as well as transfer payments such as foreign aid and remittances.
Body Mass Index (BMI)	It is a measure of body fat adjusted for the height of the individuals. It is measured as the body weight in kg divided by height in metres squared. Thus, if height is 175 cm and weight is 70 kg, then $BMI = 70 / (1.75 * 1.75) = 22.86$ (since 1 metre is = 100 cms, 175 cms = 1.75 meters).
Centripetal/Centrifugal Effects	These are the concepts from Newtonian mechanics. Centrifugal effect means the inertial force directed away from the rotation that affects all objects at the time of rotation. In economics, we can say that Centrifugal force pulls population apart and on the other hand, Centripetal effect pulls population together.
CDS (Current Daily Status) Unemployment	This approach measures unemployment in terms of 'person days' during the reference week.
CWS (Current Weekly Status) Unemployment	A person is treated as unemployed by this method, if a person who is available for work, does not find work even for one hour during the reference week.

Current Account Deficit	It is a measurement of a country's trade where the value of goods and services imported exceeds the value of goods and services it exports. The current account includes net income (e.g. interest and dividends) and transfers (e.g. foreign aid) although these components account for only a small percentage of the total current account.
Debt-GDP Ratio	This is the ratio between a country's government debt (a cumulative amount) and its GDP. A low debt-to-GDP ratio indicates that an economy can produce and sells goods and services sufficient to pay back its debts without incurring further debt.
Demographic Transition	It is the process by which countries transit from a situation of high birth and death rates to one of low rates in both birth and death.
Democracy Index	An Index developed and published by The Economist's Intelligence Unit. It surveys more than 165 countries and bases its democracy index on five categories viz. electoral process and pluralism, the functioning of the government, political participation, political culture and civil liberties.
Density of Population	Refers to the number of people per square km of land area.
Desertification	It is a process by which fertile land becomes desert, as a result of drought, deforestation, inappropriate agriculture, etc.
Dictatorship	Refers to an authoritarian regime in which the concentration of power lies in a few hands.
Disguised Unemployment	Also referred to as hidden unemployment, it exists when the labour force is either left without work or is working in such a manner where its marginal productivity is zero.
Economic Planning	Economic planning is the process by which central governments makes key economic decisions. It is in contrast with the laissez-faire which eschews any attempt to guide the economy, relying instead on

	market forces to determine the speed, direction and nature of economic evolution.
Foreign Direct Investment	Foreign direct investment (FDI) is an investment made by an investor from another country in tangible capital assets like infrastructure, production unit, etc.
GFR	Refers to the number of births per year per thousand women of child bearing age.
Governance	Governance encompass the legal frameworks for the rule of law, accountability of public officials, transparency in government procedures and practices, freedom for information access and participation of citizens through civil society organisations.
Governance	The term subsumes institutions of state and beyond. In the latter, it includes many non-state institutions.
Good Governance	Refers to that form of governance which ensures 'political, social and economic priorities' based on a broad consensus in society in which the voice of poor and the vulnerable is also included.
Governance Indicators	Are indicators like 'World Wide Governance Indicators' (WGI: developed by Brookings and WB) and the 'Corruption Perception Index' (developed by Transparency International).
Growth Rate	Measures how fast a variable is increasing. When it is economic growth rate, it refers to how an economy is growing. It does this by comparing one quarter of the country's GDP to the previous quarter. Averaged over the four quarters, it gives us the annual growth rate.
GER	Reveals the general level of participation in education.
GPI (Gender Parity Index)	Refers to the ratio of GER for females to males.
Head Count Ratio (HCR)	A method of measuring poverty in which the total number persons below the poverty line income would be divided by the total number surveyed or in the population.

Human Capital	Treating education as an investment in human beings, it refers to the cumulative wealth of trained persons in the society.
Human Development	Refers to the process of enlarging people's freedoms and opportunities thereby improving their overall well-being.
Inclusive Growth	Inclusive growth is economic growth that creates opportunity for all segments of the population and distributes the dividends of increased prosperity, both in monetary and non-monetary terms, in a fair manner across all sections of the society.
Incremental Capital output Ratio (ICOR)	ICOR indicates additional unit of capital (or investment) required to produce an additional unit of output. From Harroddian equation we can say that <i>Incremental Capital-Output Ratio (ICOR)</i> , is the <i>ratio</i> of investment to growth. The higher the <i>ICOR</i> , the lower is the productivity of <i>capital</i> .
Junk-Grade Debt	Long-term credit ratings, denoted as triple A (AAA) is the highest credit quality. C or D (depending on the agency issuing the rating) is the lowest or junk quality. In case of downgrade in credit rating, the government has to pay more in debt servicing costs. This means that it will have less to spend on social initiatives and infrastructure. In order to plug the funding gap, government will have to increase revenue through higher taxes.
Learning Poverty	Refers to the ability to read and understand a short age-appropriate text by age 10. This is an indicator developed by WB to assess the quality of education.
Mixed Economy	This is defined as an economic system consisting of a mixture of both the public and private sector enterprises operating in a mutually coexisting manner. In most cases, 'mixed economy' refers to market economies with strong regulatory oversight and governmental presence in provisioning the public goods and expanding the infrastructural base of the economy to facilitate efficient functioning of markets.

Natural Resource	Natural resources are materials provided by nature which mankind uses to make complex products.
Per Capita Income	Per capita income is a share of national income, on an average that each person is getting. It can be calculated by dividing national income by the total population.
Physical Infrastructure	Physical Infrastructure is directly related with the production sectors like agriculture, industry and trade. It includes facilities like power, irrigation, transport telecommunication.
Poverty Line	A minimum level of income required to purchase the basic necessities expressed on per capita basis below which any person would be deemed poor i.e. below poverty line person.
Poverty Gap Index (PGI)	This is a measure of severity of poverty in which persons whose income is above the poverty is numerically considered 'zero' (i.e. above poverty line) and persons with income below the poverty line would be numerically considered equal to the difference between the actual income and the notional equivalent of poverty line level income.
Rate of Growth of Population	Refers to the change in the size of population expressed as a percentage to its base year population value.
Resource	A resource is a source of supply from which beneficial goods and services can be produced.
Social Progress Index	Is a measure developed to assess the capacity of a society to meet its basic human needs. It encompasses two other aspects besides human needs viz. foundations of well being and opportunities.
Structural Change	Refers to changing dominance of industry-GDP and services-GDP with a transition from a high agriculture-GDP shares.
Special Drawing Rights	An instrument created to replace gold. SDRs are used as a unit of account by the IMF. They are 'potential claims' on the

	freely usable currencies of IMF members.
Squared Poverty Gap Index (SPGI)	The PGI assigns equal weight to each person below the poverty line. This makes the PGI insensitive to the degree of poverty. The SPGI removes this deficiency by assigning weights equal to the actual extent of poverty which ensures greater weight to those whose poverty status is acute relative to others.
Stable Population	A Population is called stable when its size grows/diminishes over time at a constant rate and each age group has a constant share of total population.
Structural Change	This is defined as the outcome of economic growth in which major change in the shares of different sectors of income or employment is evidenced. For instance, the decline in the share of agricultural employment by over 20 percent during the period 1951-2012 is a structural change in the Indian economy.
Still Birth Rate	Still birth refers to the death of an infant in the womb after 28 weeks of pregnancy. It is measured as 'the number of still births per 1000 births (including live and still births) during the year'.
Sustainable Development	<i>Sustainable development</i> is a way for people to use resources without the resources running out for successive generations. The term used by the Brundtland Commission defined it as development with sustainability that 'meets the needs of the present without compromising the ability of future generations to meet their own needs'.
TFR	It is the summation of age specific fertility rates (ASFR) which is the 'ratio of number of live births per woman to the mid-year female population of a particular age-group.
TFR	TFR is the average number of children that would be born in the reproductive age of a girl/woman if she were to survive her entire reproductive life. The value of TFR is taken as 2.1 because it is the average number of children a woman would potentially have if she was subject to the

	prevailing fertility rates.
Terms of Trade	Refers to the relationship between exports and imports. It is the relative price of a country's exports to imports.
Under Employment	Is a situation when a part of labour force is willing to work but not getting work as per their skill, education and capacity.
UPS (Usual Principal Status) Unemployment	As per this concept, a person is considered unemployed if he is available for work but could not get work for major part of the year.
UPSS (Usual Principal and Subsidiary Status) Unemployment	Besides the UPS as defined above, this category of unemployed includes those who could not even get work on a 'subsidiary basis' during a year.
Urbanisation	Urbanisation is a process that influences the rural-urban distribution of population in a country. It increases by: (i) natural increase of urban population; (ii) migration from rural areas; and (iii) transformation of rural areas into urban through upgrading of places into new towns, establishment of new industrial townships and growth of urban agglomerations.
Waves of Democracy	Refers to shift of power from monarchy to representative governments through a long history marked for: the Glorious Revolution of England in 1688, the French Revolution in 1789 and the disintegration of USSR in the late 1980s.
Z-Score	Z score is the 'ratio' of the 'difference between the actual value (or the observed value) and the median value' and the 'standard deviation' of the values in the sample. Since the numerator of the ratio is a difference between the actual and the median value for a population, some Z scores are positive and some are negative. It is positive when the actual value is greater than the median value. This is an indicator of good health. The opposite is the case when the Z score is negative i.e. when the actual value is less than the median, the negative value of Z is an indicator of poor health.

STATISTICAL APPENDIX

Table 3.2 (a): Sectoral Share (%) of GDP: 2013-21 (base 2011-12)

Year	Agriculture	Industry	Services
2013-14	20.7	28.3	51.1
2016-17	18.3	28.4	53.3
2019-20 (PE)	17.3	27.5	55.2
2020-21 (AE)	18.8	26.9	54.3

Source: Table 1.3 B, A7, Economic Survey 2020-21.

Note: PE: Provisional Estimates. AE: Advanced Estimates

**Table 3.3: Domestic Savings as Percentage of GDP: 2012-19
(2011-12 Series)**

Sector	2011-12	2014-15	2017-18	2018-19
Household	23.6	19.6	19.2	18.2
Private	9.5	11.7	11.6	10.4
Corporate				
Public Sector	1.5	1.0	1.7	1.5
Total	34.6	32.2	30.5	30.1

Source: Table 1.9, A 26, Vol. 2, Economic Survey 2020-21.

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