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THEORIES OF ECONOMIC DEVELOPMENT AND IMPACT OF GLOBALIZATION IN INDIA

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Abstract
Developing countries are trying to speed up the rate of economic growth and they are experimenting different growth and development models to achieve this goal. India is no exception and is trying to raise the rate of growth of income from the very beginning of its planning efforts. But the country has not been able to attain these targets. Majority of other developing countries also have not been successful in fulfilling these growth targets. These historical facts call for the need of analysis and examination of existing development theories. The classical school, Harrod-Domar model, neo-classical model and the new growth theory represent the four major trends in the history of economic growth. These theories try to explain the process of economic development with the help of important economic variables. Therefore, the proper combination of all those variables and techniques may be the solution to our problem. Globalization is a move towards a borderless regime of free trade and transactions based on c01npefition. For countries of Asia, Africa and Latin America, which sought to undo the colonial past, this means a series of economic reforms towards liberalization as all of them had resorted to a controlled regime in order to have an autonomous development of their own. Beginning 1980s, most countries of the world have taken to market mediated economic reforms and liberalization. India is a latecomer and efforts towards reform and strong liberalization had started only in July 1991.

Introduction

Various models and theories exist that prescribe specific ways to achieve the overall societal goal of development. Economic growth is regarded as the most important requirement for the development of progress of a society. Therefore, developing countries are trying to speed up the rate of economic growth and they are experimenting different growth and development models to achieve this goal. India is no exception and is trying to raise the rate of growth of income from the very beginning of its planning efforts. But the country has been unable to attain these targets. Majority of other developing countries also have not been successful in fulfilling these growth targets. This historical fact leads to a need for the analysis and examination of development theories. This paper is also an effort to make such an analytical study of globalization in India.

Objectives and Methodology

The objective of this study is to analyze the major theories of development and to suggest appropriate approaches to be followed by developing countries to develop themselves. Its next objective is to clarify the, impact of globalization on Indian economy. The methodology adopted in this study is the use of secondary information published in books and journals. The terms growth and development are used in this study to give more or less the same meaning.

Major Trends in Growth Theories

We all know that development refers to the overall up-liftment of a society. Overall development refers to the sum-total of economic, social and political up-liftment of a society. Thus, overall up-liftment or development refers to the enhancement of the economic and social condition of the people. We also know that eradication of poverty and economic growth and especially the income growth of low-income people is the major prerequisite of development.

We also know that "all countries were once at subsistence level, and as recently as 200 years ago, at the advent of the British industrial revolution, the absolute differences in living standards between countries were not so great, (Thirlwall, 1989). But the situation has changed now. We find that low-income countries contain approximately half the world population. Out of the world's 606 billion people, 302 billion-almost half-live on less than $ 2 a day, (World Bank, 2006). Similarly, low-income countries receive only 6 per cent of the world's income; the middle-income countries receive 17 per cent of world income and the rich industrialized countries (with less than 15 per cent of the total population) receive more than 77 per cent of the world income (Thirlwall, 1989).

Therefore, economic prosperity and poverty eradication has remained a great challenge to the world community, especially the developing ones. Purchasing power, educational achievement and life expectancy at birth are the three components of human development index (HDI). Educational attainment and life expectancy at birth are largely influenced by the per capital income of a society. Therefore, economic growth is often regarded as the major contributor to know the major trends in the growth thoughts.

Growth and development theory is as old as economics itself according to A.P-Thirlwall (1989). He opines that the great classical economic of the eighteenth and nineteenth centuries were all development economist writing about forces determining the progress of nations as the countries of Europe embarked on the process of industrialization.
He divides the theories on the growth and development process into five different categories:

a. The Classical school,
b. Keynesian growth theory, as represented by the Harrod-Domar growth model,
c. Neo-classical growth theory,
d. The production function approach to the analysis of growth, and
e. New (endogenous) growth theory. (Thirlwall, 1989)

Similarly, M.P. Todaro classifies the post-world war II literature on economic development into five major and sometimes competing strands of though: (1) the linear stages of growth model, (2) theories and patterns of structural change, (3) the international dependence revolution, (4) the neo-classical, free-market counter revolution and (5) the new endogenous theory of economic growth, (Todaro, 1997). But Thorvaldur Gylfason recognizes three different revolutions in the history of the theory of economic growth. They are: (1) the first revolution-Adam Smith (2) The second revolution: The neo-classical model and (3) the third revolution: endogenous growth (Gylfason, 1999). He includes the Harrod-Domar model as an integral part of the first revolution.

Like M.P. Todaro, G.M. Meier also recognizes the dependence theories of under development as a separate line of though in economic growth. He also mentions that the new institutional economics and development theory as representing a separate line of thought (Meier, 1997). Meier considers also the importance of the new market failures approach.

In my opinion, development and growth theories can be divided in following four major categories, although we should not forget that the economics of development relies for the most part on the fundamental principles of mainstream economics-resource allocation, international trade theory and the macroeconomics of monetary and fiscal policies.

a. The Classical School
b. Harrod-Domar model of Economic Growth
c. Neo-Classical School
d. The New-Growth Theory

A brief introduction of these four major theories and model will be made now.

(a) The Classical School/First Revolution

Adam Smith (1723- 1790) also called father of political economy, is the founder of classical school. His work An Inquiry into the Nature and Causes of the Wealth of Nations (1776) is generally regarded as the starting point of Classical school. According to Keynes, the classical economists' was a name invented by Marx to cover Ricardo and James Mill and their predecessors. But Keynes included the followers of Ricardo, that is to say, who adopted and perfected the theory of the Ricardain economics into the classical school. These economists include J ,S. Mill, Marshall and Edgeworth. Thus Adam Smith, Jeremy Benthem, Thomas Robert Malthus, David Ricardo, J .B. Say and J.S. Mill are the leading economists of the Classical School. Of them, Smith, Ricardo (1772-1823) and J.S. Mill (1806-1873) formed the classical trinity (Lokanathan, 1984). Malthus (1766-1834) and Ricardo are considered as pessimists in the history of economic thought. Karl Marx (1818-1883) was also an economist of the same period. This was the period of Industrial Revolution in Europe. A strong case can be made for including Marx in the classical school according to Benjamin Higgins (1999). As Schumpeter says, the Marxist system is part and parcel of that periods' general economics. Benjamin Higgins writes: the basic theories of production and value are much the same, in classical and Marxist models, as is the explanation of the process of economic growth. Even the theory of distribution is not really very different. Nevertheless, there are good grounds for treating the classical and Marxist models separately (Higgins, 1999). The macroeconomic issues of the growth of output and distribution of income between 'wages and profits were the major pre-occupation of all the great classical economists, including Adam Smith, Thomas R. Malthus, David Ricardo and, last but not least, Karl Marx.

According to Thorvaldur Gylfason (1990), Adam Smith may be said to have started the first revolution in growth theory. Adam Smith thought that high levels of saving and investment stimulate growth not only through the direct effects of the resulting accumulation of capital on output, but also through its indirect effects on labour productivity as well as its interaction with exchange and trade. According to him, saving and investment encourage trade and vice versa, most obviously through foreign investment, which is trade in capital.

Thus, Smith's model of development is driven by capital accumulation generated by profits from industry; and the stimulus to invest corning from the profit. The division of labour depends on the extent of the market and extent of the market depends on the division of labour according to Smith s famous theorem (Thirlwall, 1989). Smith believed in the natural organization of the economic order under the influence of personal interest. He was a great advocate of laissez-faire: non-intervention by government ill business. He believed that individuals, if left to themselves, would serve society even though it is not their intention. Man is led by an invisible hand to promote an end, which was no part of his intention. Smith illustrated the idea of harmony of interests with an example of butcher and baker. He says it is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regards to their own interest. In other words, he believed that the interest of the individuals coincide with the interest of the society (Lokanathan, 1984). He advocated a minimum role for the state in economic affairs. He considered non –intervention by government in economic matter as a wise policy.

Malthus was the only classical economist to emphasize the importance of demand for the determination of output; all others adhered to the Say's law: that supply creats its own demand, so that the level and growth of output is a function of the supply of physical inputs alone. For Malthus, effective demand must grow in line with productive potential if profitability as the stimulus to investment is to be maintained, but there is nothing to guarantee this (Thirlwall, 1989). Thus, he (Malthus) believed that production depended on the existence of effective demand that is, demand which enabled the producer to cover cost plus profit.

In Ricardo's model, like Smith's, growth and development is a function of capital accumulation and capital accumulation depends ill reinvested profits (Thirlwall, 1989).

In Marx's model, the capitalist surplus is the source of capital accumulation and the principle mainspring of growth (Thirlwall, 1989),

All members of the classical school agreed that the rate of profit on capital will fall as the economy grows, hut they differed as to the reason for that fall. Adam Smith saw the decline in profits as the result of competition among capitalists. Ricardo saw the fall as the result of diminishing returns on land, and profits being squeezed between rent and wages, leading to a stationary state. For Marx, the economy doesn't grow forever, but the end comes not from a stationary state but from crises associated with overproduction and social upheaval (Thirlwall, 1989).

Alfred Marshall agreed with Smith's concept of economic growth while adding organization as a fourth factor of production (Gylfason, 1990). Joseph Schumpeter directed the attention of growth theorists to technology through invention, innovation and entrepreneurship (Gylfason, 1990).

Keynes borrowed the concept of effective demand from Malthus (Higgins, 1999). The starting point of Keynesian theory of employment is the principle of effective demand. Total employment depends on the total demand (aggregate effective, demand) and unemployment results from a deficiency in total demand. Keynesian theory of unemployment relates to the short run (Lokanathan, 1984).

Keynes emphasized the importance of technical improvements and capital accumulation. He says (Quoted by Gylfason, 1990).

From the earliest times of which we have record-back, say, two thousand years before Christ-down to the beginning of the eighteenth century, there was no very great change in the standard of life of an average man living in the civilized centers of the earth ..... thus slow rate of progress, or lack of progress, was due to two reasons-to the remarkable absence of important technical improvements and to the failure of capital to accumulate (Keynes).

Keynes thought that the laissez-faire capitalist system based on market economy would not generate sufficient aggregate demand to maintain full employment. He argued in favour of state intervention to prevent general unemployment. The state could promote full employment either by lowering the rate of interest or by undertaking public works programmes (Lokanathan, 1984).

(b) Harrod-Domar Model of Economic Growth

Adam Smith and his followers, until the second half of this century, stated their theory of economic growth in words (Gylfason, 1990). One complication in the growth theory, which was not addressed explicitly by Smith and his followers, was with the dynamic interactions among macroeconomic variables and the associated distinction between flows (e.g. saving and investment measured in, say, dollars or pounds per year) and stocks (e.g. capital measured in, dollars or pounds at a point

in time such as the beginning of the year). Shortly before the middle of the twentieth century, Ray Harrod and Evsey Domar expressed the dynamic relationship among the macroeconomic variables in a simple equation, which neatly formalized, simplified, and summarized the essence of almost-200 years' theorizing about economic growth (Gylfason, 1990).

The Harrod-Domar model defines the rate of economic growth with the help of the following equation:

$$g = \frac{s}{v}$$

Where, g = rate of change or rate of growth of GNP (?Y/Y),
s = saving rate
v = capital output ratio

This equation says that rate of growth of an economy is equal to the ratio of rate of saving and capital output ratio. Thus, this equation says that the rate of growth of national income will be directly or positively related to the savings ratio and inversely or negatively related to the economy's capital-output ratio. This leads us to the conclusion: the more saving leads to more investment, which leads to more growth.

The works of both Harrod and Domar were, according to Basu, essentially attempts to fill the dynamic part of Keynesian macroeconomics for capitalist economies. Yet the central message of the Harrod-Domar model has been used in developing economies to conceptualize the problem of development and to determine various targets for policy (Basu, 1998).

(c) Neo-Classical Model

The neo-classical model is one of the most important contributions in the history of economic development. Kaushik Basu regards neo-classical model as the second major surge among the 3 major surges occurred in growth theory in this century (Basu, 1998). All other scholars also take neo-classical model as one of the most important achievement in the history of development thoughts.

The Harrod-Domar model said that if demand conditions were made right, the only bottleneck to growth was a lack of physical capital. In this sense, physical capital was the only ultimate source of economic growth. This line of thought left little scope (really none at all) for other factors and forces in the growth process. Population or labour-force growth is absent in the Harrod-Domar formula, which explains output growth solely by saving and efficiency. Robert Solow, therefore, developed an alternative model, that gave birth to the neo-classical model, to explain the growth process. The basic neo-classical model expanded on the Harrod-independent variable technology, to the growth equation (Todaro, 1997). Unlike the fixed coefficients, constant-returns-to-scale assumption of the Harrod-Domar model, Solow's neo-classical growth model exhibited diminishing returns to labour capital separately and constant returns to both factors jointly. Technological progress become the residual factor explaining lone-term growth, and its level was assumed by Solow and other new-classical growth theorists to be determined exogenously, that is independently of all other factors (Todaro, 1997:88).

The Solow's neo-classical growth model used the standard aggregate production function as represented by the following equation: $Y = Ae^{\mu t} K^{\alpha} L^{1-\alpha}$

Here Y is gross domestic product, K is the stock of human and physical capital, L is unskilled labor, A is a constant that reflects the base level of technology, and e^{i} reflects the constant exogenous rate at which technology grows (Todaro, 1997). Similarly, á is the elasticity of output with respect to capital and l-á is the elasticity of output with respect of labour and sum of these two elasticity equals to one. Thus, in the long-run steady rate, the growth of output is determined by the rate of growth of labor force in efficiency units, that is, by the rate of growth of the labour force plus the rate of growth of labour productivity (exogenously given as in Harrod's natural rate of growth), and is independent of the ratio of saving and investment to GDP. This is so because a higher savings or investment ratio is offset by a higher capital output ratio or lower productivity of capital, because of the neo-classical assumption of diminishing returns to capital (Thirlwall, 1989).

Thus, according to Solow, saving behavior was no longer relevant for long-run growth, nor was efficiency in a broad sense, except insofar as it mattered for technology. As population growth and technological progress were outside the purview of pure economics and thus outside the reach of economic policy, economic growth came to be widely seen as exogenous in the long run from an economic point of view (Gylfason, 1990).

One of the major points of criticism made against neo-classical theory in recent years is based on the argument of this theory that investment does not matter for long-run growth. Exogeneity of the technological progress has also been questioned by many scholars.

(d) The New Growth Theory/Endogenous Theory

The neoclassical theory suggested that the low capital labor ratios of Third World countries promise exceptionally high rates of return on investment. The free-market reforms, therefore, should prompt higher investment, rising productivity, and improved standards of living. Yet even after the prescribed liberalization of trade and domestic markets, many LDCs experienced little or no growth and failed to attract new foreign investment or to halt the flight of domestic capital. The anomalous behavior of Third World capital flows (from poor to rich nations) helped provide the impetus for the development of the newest approach to the economics of growth and development: the concept of endogenous growth or, more simply, the new growth theory (Todaro, 1997).

The new growth theory relaxes the assumption of diminishing returns to capital and shows that, with constant of increasing returns, there can be no presumption of the convergence of per capita incomes across the world, or of individual countries reaching a long-run steady state growth equilibrium at the natural rate. If there are no diminishing return to scale, investment is important for long-run growth and growth is endogenous in this sense. In these new models of endogenous growth, pioneered by Robert Lucas (1988) and Paul Romer (1990), there are assumed to be positive externalities associated with human capital formation (for example education and training) and research and development that prevent the marginal product of capital from falling and capital output ratio from rising (Thirlwall, 1989).

Many endogenous growth theories can be expressed by the simple equation Y = AK. In this equation, A represents any factor that affects technology and K includes both physical and human-capital. There are no diminishing returns to capital in this formula; so the possibility exists that investment in physical and human capital give rise to external economics and productivity improvements that exceed private gain by an amount sufficient to offset diminishing returns. This, in turn, creates the further possibility that investments that generate these external economics cause L in the Solow equation to equal unity so that the neo-classical growth equation $\mathbf{Y = Ae^{\mu t} K^{\alpha} L^{1-\alpha}}$ reduces to the endogenous growth equation $\mathbf{Y = Ae^{\mu t} K^{\alpha} L^{1-\alpha}}$. The net result is sustained long-term growth resulting from increasing returns to scale-an outcome prohibited by traditional neoclassical growth theory (Todaro, 1997).

Impact of Globalization in India

Globalization is the process of integration of world's economies in conditions of freer flows of trade and capital and movement of persons across borders, facilitated by new technologies of instant communication of information. More than 1.5 trillion dollars is exchanged in the world's currency markets functioning 24 hours a day. Nearly 40 per cent of global output of goods and services is traded.

The world has seen periods of economic integration in the latter half of 19th century and early part of 20th century, Massive migrations had taken place from Europe and Asia to North and South America. Trade expanded in the 19th century and new technologies of steam power and telegraphs and telephones brought goods and people closer together. The World Bank records this process was interrupted by wars, economic depression, protectionism and restrictions on the movements of people in the 20th century till almost the 1970s.

Internationalization of production has been taking place over the last few decades through the Multinational Corporations (MNCs), which operate with tens of thousands of affiliates. Their sales in 1998 were of the order two trillion dollars, almost one-third of the world trade in merchandise.

As tariff and other barriers are getting lowered, trade is expanding, transport and communication costs fall, and technologically advanced enterprises move to different locations, globalization is turning the whole world into a common village. The, era or globalization, which gained momentum in 1990s, has opened up new opportunities for countries, developed and developing, but also poses serious risks to countries which are unable to reform their own markets and become internationally competitive.

Notwithstanding the risks and challenges flowing from globalization, no single country, not even a group of countries even if they act together, would be able to arrest the march of liberalization and globalization.

Today’s globalization is being driven by market expansion (opening national borders to trade, capital, information), which is outpacing governance of these market and their repercussions for people. More progress has been made in norms, standards,

policies and institutions for open global markets than for people and their rights. Competitive markets may be the best guarantee of efficiency, but not necessarily of equity. Markets are not the only factors in human development. Many activities and goods that are critical to human development are provided outside the market but these are getting squeezed by the pressures of global competition, When the market gets out of hand, the instabilities show up on boom and bust economies, as in the 1997 financial crisis in East Asia and its worldwide repercussion, cutting global output by an estimated $2 trillion in 1998-2000.

The challenges of globalization in the new century is not to stop the expansion of global markets but one of setting rules and institutions for Stronger governance-local, national, regional and global-to preserve the advantages of global markets and competition, but also to provide enough space for human, community and environmental resources to ensure that globalization works for people- not just for profits.

At present as stated earlier, for many developing countries, including India, the risks outweigh advantages and opportunities under I' globalization. For instance, in India the 1990s has seen more .retrenchment as firms, downsize or merge to stand the rigors of competition. This is happening in a milieu when GDP growth is not generating jobs. Trade liberalization has unavoidably resulted in a flood of cheaper imports into the century, which hurt local manufacturers.

Globalization has also impacted on income levels with the rich getting richer, given their ability to adjust easily to a new environment, and the poor getting poorer. Even developed countries are no exception to income inequalities in the wake of spread for globalization processes. There is thus a growing tide of opinion at the people's level, which is one for resistance to externally imposed disciplines. There are equally concerns, whether in the WTO negotiations on agriculture, services and patent protections, developing countries would get a fair deal to safeguard their development and a level playing fielding trade exchanges or movement of services personnel. More basic concerns relate to the ways in which the rapid spread of communication and images might effect people's lives and traditional cultures and drive countries to conformity to a single pattern.

Overall, the international community had not moved decisively till mid- 2001 to evolve a new economic order, which is more equitable to all, nor it had gone far in creating a new financial architecture which will ensure stability in the movement of key currencies and orderliness in world's financial markets.

The Rationale of Economic Reforms: The Indian Case

Economic reforms that seek to usher in globalization are not directly addressed to poverty. The acknowledged logic of globalization as rationalized by World Bank and IMF is expressed in two concepts, stabilization and structural adjustment. While stabilization measures are short-term packages, administered by the Fund, structural adjustment packages are long-term measures towards deregulation, liberalization and privatization largely supervised by the Bank. The economic logic underlying these measures rests on the assumption that market mediated growth will ensure efficient allocation of resources. A series of trade, industrial and financial reforms to open up India's economy by dismantling tariffs, quota restrictions, licensing, capital control, labour market policies etc. were made in great speed and quick succession form July 1991. Several tax measures reducing and rationalizing the rate structure largely for the benefit of the business community too have been taken. The reform process continues despite the changes of government in the Centre. Two issues here are whether the reforms have promoted growth and whether they have succeeded in reducing Poverty.

Impact on Growth

India’s real GDP grew at the rate of 5.5 per cent during 1991-2001 according to the National Accounts Statistics. This was way above the so-called Hindu growth rate of 3.5 per cent that characterized the early post-independence years. During the reform period 1990-97, GDP grew at the rate of around 6 percent. It is also important to note that during 1993-94 through 1996-97, the growth rate was above 7 per cent. Clearly, the overall growth rate of the reform period was above that of the previous decade. The fabulous trajectory of growth, which the reform was expected to provide, however, did not happen.The key to alleviate the poverty is linked to agricultural growth. Indeed the growth in agriculture during the reform period has been more than that of the earlier periods. During the decade 1978-88, agriculture registered about 2.8 per cent rate of annual growth. In the decade that followed, i.e. 1988-98, the rate of growth was 3.1 per cent a year. In fact, in 1998, it was a high 7.2 per cent growth, though due to a very low base in 1997 which had registered a negative growth. Hence, the issue is here is whether the growth especially in agriculture, helped to reduce poverty.

Impact on Poverty

There was a clear trend towards decline rural and urban poverty till 1990-91. Not only that the disparity also narrowed. The pre-reform period poverty fell by 36.5 percent from 55.72 percent in 1973-74 to 35.37 percent (average for 1989-91) and

urban poverty by 31 percent from 47.96 to 33.08 percent during the same period. However, the situation significantly changed since the commencement of the reform. The rural-urban poverty lines, which almost intercepted in 1989-90, sharply widened during the reform period, While rural poverty increased by 3,10 percent points, Urban poverty declined by 12.3 percent. This proves that the overall situation of poverty became worse after the reform, because most of the people live in villages. S.P. Gupta's estimate covering 1998 places the number of people below the poverty at 43.01 percent. At today's population, this works out to be 430 million, a figure well above India's total population in 1951. This magnitude is simply alarming.

Impact on Employment

Regular gainful employment is the best entitlement to fight poverty and food insecurity. Reforms have to be judged in terms of the regular gainful employment they provide. Several studies point out that in-formalization of labour market, casualization of labour and ferninization of work force are important consequences of globalization. In India, nearly 91 percent of employment is in the informal sector, such as agricultural labour, self-employed, casual labour, etc. Organized sector employment growth rate has almost steadily declined during the reform period and in two years (1996 and 1998) it was even negative. True, the organized private sector has registered good growth in some years, but its total impact has been negligible as it does not account for a significant place in the total scenario.

Conclusion

The above discussion makes it clear that there is yet no consensus in development model to use as a single instrument to carry a society towards the path of prosperity and happiness. It is difficult and rather inappropriate to prescribe a single theory or model as the only effective and applicable one, Different theories and models have drawn our attention towards specific variables and techniques useful for development. Therefore the proper combination of those all variables and techniques may be the solution to our problem. The work of finding the exact nature of this combination is still to be completed.

Similarly the work of defining the relationship between economic development and poverty also is not an easy task. Whether the eradication or alleviation of poverty leads automatically to economic growth or the economic growth leads automatically to the eradication or poverty is a difficult question for planners and economists. Therefore, the relation between growth and poverty alleviation is not more different from the between the egg and hen riddle. By we know that economic growth and poverty alleviation both indicate betterment of the society and both are the goals, ideals and challenges for the world, especially for the developing countries. Therefore, the work of defining the exact relationship between the processes of economic growth and poverty alleviation has also not yet been completed.

According to a UN study, the era of globalization is opening many opportunities for millions of people around the world. Increased trade, new technologies, foreign investments, 20 expanding Media and Internet connections are fuelling economic growth and human advance. All this offers economic potential to eradicate poverty in the 21st century.

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