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NATIONAL OPEN UNIVERSITY OF NIGERIA

DEVELOPMENT ECONOMICS II

ECO 348

FACULTY OF SOCIAL SCIENCES

COURSE GUIDE

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Course Information

Course Code: ECO 348
Course Title: Development Economics II
Course Unit: 2
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Course Blub:
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Required Hours for Study**:** Two Hours for each unit

Course Team

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INTRODUCTION

Welcome to ECO: 348 DEVELOPMENT ECONOMICS II.

ECO 348: Development Economics II is a two-credit and one-semester undergraduate course for Economics Students. The course is made up of Seventeen units spread across fifteen lecture weeks. This course guide gives you an insight into Development Economics II which is a follow-up/continuation to Development Economics I in Year Three First Semester. It tells you about the course materials and how you can work your way through these materials. It suggests some general guidelines for the amount of time required of you on each unit to achieve the course aims and objectives successfully. Answers to your tutor-marked assignments (TMAs) are therein already.

Course Competences

This course is basically on economic development, which is an extension of a broader discussion of what is happening in the economy and the players of the economy. The topics covered include Governance and Corruption, Civil Society and Development, Globalization and Poverty, and Equity and well-being.

Course Objectives

To achieve the aims of this course, there are different specific objectives which the course is out to achieve which are set objectives for each unit. The unit objectives are included at the beginning of a unit; you should read them before you start working through the unit. You may want to refer to them during your study of the unit to check on your progress. You should always look at the unit objectives after completing a unit. This is to assist you in accomplishing the tasks entailed in this course. In this way, you can be sure you have done what was required of you by the unit. The objectives serve as study guides for you. At the end of the course period, you are expected to be able to:

- Define the meaning of good governance and good policy
- Explain the meaning of corruption
- Identify different corrupt practices
- Enumerate different measurements of corruption
- Explain the meaning of civil society
- Highlight the importance of civil society
- Evaluate good governance
- Explain the meaning of macroeconomics as a field of study
- Identify the basic macroeconomics concepts
- Highlight evidence from the Global Corruption Barometer (GCB) on petty bribery.

- Enumerate the problems of corruption.
- Identify the rationales of public sector activities
- Explain the meaning of public and merit goods
- Describe the importance of civil society for the operation of state and market
- Highlight the meaning and history of globalization
- Enumerate the fundamentals of globalization
- Describe the pre-First World War and the Second Wave of Globalization
- Differentiate between international organizations and globalization
- Understand how technology can be used as a means of information
- Define the meaning of international trade
- Describe the gains from trade with other nations
- highlight the impact of trade liberalization on growth and poverty

Working Through The Course

To complete this course, you are required to read the study units, referenced books and other materials on the course. Each unit contains self-assessment exercises called Student Assessment Exercises (SAE). At some points in the course, you will be required to submit assignments for assessment purposes and at the end of the course, there is a final examination. This course should take about 15 weeks to complete and some components of the course are outlined under the course material subsection.

Study Units

There are 17 units in this course which should be studied carefully and diligently.

MODULE 1: GOVERNANCE AND CORRUPTION

Unit 1: Good Governance and Good Policy
Unit 2: Corruption as a Developmental Issue
Unit 3: Rating Corruption across the World
Unit 4: Corruption Justification
Unit 5: Public Sector Scope and Enhancing Public Sector Performance

MODULE 2: CIVIL SOCIETIES AND DEVELOPMENT

Unit 1: The Roles and Potentials of Civil Societies
Unit 2: Positive Feedback Mechanisms of Civil Societies
Unit 3: Change in Behaviour: Generalizations from the Four Cases

MODULE 3: GLOBALIZATION AND DEVELOPMENT

Unit 1: Concept of Globalization
Unit 2: The New Globalization
Unit 3: International Trade
Unit 4: International Financial Flows

MODULE 4: POVERTY, EQUITY AND WELL-BEING

Unit 1: Definition and Conceptualization of Poverty
Unit 2: Measurement of Equality of Distribution
Unit 3: Measurement and Assessment of Poverty
Unit 4: Priority for Growth-Targeted Versus Poverty-Targeted Interventions

Each study unit will take at least two hours, and it includes the introduction, objectives, main content, self-assessment exercise, conclusion, summary and references. Other areas border on the Tutor-Marked Assessment (TMA) questions. Some of the self-assessment exercises will necessitate discussion, brainstorming and argument with some of your colleagues. You are advised to do so to understand and get acquainted with economic events.

There are also textbooks under the reference and other resources including online resources for further reading. They are meant to give you additional information, hence you need to source for them. You are required to study the materials; practice the self-assessment exercise and tutor-marked assignment (TMA) questions for a greater and in-depth understanding of the course. By doing so, the stated learning objectives of the course would have been achieved.

References and Further Readings

For further reading and more detailed information about the course, the following materials are recommended:

African Development Bank. (2012). *Framework for Enhanced Engagement with Civil Society Organisations.* Abidjan: African Development Bank.
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Nafziger. W. (2006). Economic Development, 4th Edition. UK: Cambridge University Press.

Olofin, S. O. & Salisu, A. A. (2015). *An introduction to Macroeconomics, 1st Edition*. Lagos: Evans Publishers.

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VanDyck, C., K. (2017). *Concept and Definition of Civil Society Sustainability*. Washington DC: Centre for Strategic and International Studies. https://csisprod.s3.amazonaws.com/s3fspublic/publication/170630_VanDyck_CivilSocietySustainability_Web.pdf?QfxMIeHr9U8aeV1kOjFo.FBTsLG76HPX

Presentation Schedule

The presentation schedule included in the course materials gives the important dates for the completion of tutor-marking assignments and attending tutorials. You are required to submit all assignments before or on the due date. Kindly guide against falling behind in your work as this may affect your overall result.

Assessment

The course will be assessed using two formats: Tutor-marked assignments as well as a written examination. The assignments submitted to your tutor for assessment will count for 30% of your total course mark while the final written examination of will count for the remaining 70% of your total course mark.

How to Get The Most From This Course

In distance learning, the study units replace the university lecturer. This is one of the great advantages of distance learning; you can read and work through specially designed study materials at your own pace and at a time and place that suit you best.

Think of it as reading the lecture instead of listening to a lecturer. In the same way that a lecturer might set you some reading to do, the study units tell you when to read your books or other materials, and when to embark on discussions with your colleagues. Just as a lecturer might give you an in-class exercise, your study units provide exercises for you to do at appropriate points.

Each of the study units follows a common format. The first item is an introduction to the subject matter of the unit and how a particular unit is integrated with the other units and the course as a whole. Next is a set of learning objectives. These objectives let you know what you should be able to do by the time you have completed the unit.

You should use these objectives to guide your study. When you have finished the unit you must go back and check whether you have achieved the objectives. If you make a habit of doing this you will significantly improve your chances of passing the course and getting the best grade.

The main body of the unit guides you through the required reading from other sources. This will usually be either from your set books or from a readings section. Some units require you have an overview of historical events. You will be directed when you need to embark on discussions and guided through the tasks you must do.

The purpose of the practical overview of certain historical economic issues is twofold. First, it will enhance your understanding of the material in the unit. Second, it will give you practical experience and skills to evaluate economic arguments, and understand the roles of history in guiding current economic policies and debates outside your studies. In any event, most of the critical thinking skills you will develop during studying are applicable in normal working practice, hence you must encounter them during your studies.

Self-assessments are interspersed throughout the units, and answers are given at the end of the units. Working through these tests will help you to achieve the objectives of the unit and prepare you for the assignments and the examination. You should work on each self-assessment exercise as you come across them in each study unit. Do not hesitate to consult your tutor when you run into any difficulties/challenges.

The following is a practical strategy for working through the course.

1. Read this Course Guide thoroughly.
2. Organize a study schedule. Refer to the `Course overview' for more details. Note the time you are expected to spend on each unit and how the assignments relate to the units. Important information, e.g. details of your tutorials, and the date of the first day of the semester is available from the study centre. You need to gather together all this information in one place, such as your diary or a wall calendar. Whatever method you choose to use, you should decide on and write in your dates for working on each unit.
3. Once you have created your study schedule, try as much as possible to stick to it. The major reason that students fail is that they get behind with their coursework. If you get into difficulties with your schedule, please let your tutor know before it is too late to get help.
4. Turn to Unit 1 and read the introduction and the objectives for the unit.
5. Assemble the study materials. Information about what you need for a unit is given in the `Overview' at the beginning of each unit. You will also need both the study unit you are working on and one of your set books on your desk at the same time.
6. Work through the unit. The content of the unit itself has been arranged to provide a sequence for you to follow. As you work through the unit you will be instructed to read sections from your set books or other articles. Use the unit to guide your reading.
7. Up-to-date course information will be continuously delivered to you at the study centre.

8. Work before the relevant due date (about 4 weeks before due dates) and get the Assignment File for the next required assignment. Keep in mind that you will learn a lot by doing the assignments carefully. They have been designed to help you meet the objectives of the course and, therefore, will help you pass the exam. Submit all assignments no later than the due date.
9. Review the objectives for each study unit to confirm that you have achieved them. If you feel unsure about any of the objectives, review the study material or consult your tutor.
10. When you are confident that you have achieved a unit's objectives, you can then start on the next unit. Proceed unit by unit through the course and try to pace your study so that you keep yourself on schedule.
11. When you have submitted an assignment to your tutor for marking do not wait for its return `before starting on the next units. Keep to your schedule. When the assignment is returned, pay particular attention to your tutor's comments, both on the tutor-marked assignment form and also written on the assignment. Consult your tutor as soon as possible if you have any questions or problems.
12. After completing the last unit, review the course and prepare yourself for the final examination. Check that you have achieved the unit objectives (listed at the beginning of each unit) and the course objectives (listed in this Course Guide).

Online Facilitations and Tutorials

There are some hours of tutorials (2-hours sessions) provided in support of this course. You will be notified of the dates, times and location of these tutorials. Together with the name and phone number of your tutor, as soon as you are allocated a tutorial group.

Your tutor will mark and comment on your assignments, keep a close watch on your progress and on any difficulties you might encounter, and provide assistance to you during the course. You must mail your tutor-marked assignments to your tutor well before the due date (at least two working days are required). They will be marked by your tutor and returned to you as soon as possible.

Do not hesitate to contact your tutor by telephone, e-mail, or discussion board if you need help. The following might be circumstances in which you would find the help necessary. Contact your tutor if.

• You do not understand any part of the study units or the assigned readings

• You have difficulty with the self-assessment exercises

• You have a question or problem with an assignment, with your tutor's comments on an assignment or with the grading of an assignment.

You should try your best to attend the tutorials. This is the only chance to have face-to-face contact with your tutor and to ask questions which are answered instantly. You can raise any problem encountered in the course of your study. To gain the maximum benefit from course tutorials, prepare a question list before attending them. You will learn a lot from participating in discussions actively.

Module 1: Governance and Corruption

This Module introduces you to the issues of governance and corruption. The following specific units will guide you in understanding what is meant by good governance, how the public sector enhances development and the effect of corruption on development.

Unit 1: **Good Governance and Good Policy**
Unit 2: **Corruption as a Developmental Issue**
Unit 3: **Rating Corruption across the World**
Unit 4: **Corruption Justification**
Unit 5: **Public Sector Scope and Enhancing Public Sector Performance**

Unit 1: Good Governance and Good Policy

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1.2. Learning Outcomes
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1.4. Importance of Civil Society
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1.6. Summary
1.7. References/Further Readings/Web Resources
1.8. Possible Answers to Self-Assessment Exercises (SAEs)

1.1 Introduction

Since the 1990s, governance – the quality of government – has become explicitly and generally recognized as a highly important element in economic growth and in the enhancement of all the aspects of welfare that are covered by ‘development’.

In this unit, we distinguish between good government and good policy, and we represent government, the market and civil society as three resources on which countries can draw to enhance their people's welfare. We review the interconnected elements that determine the quality of government; and explain the reason for concentrating on questions of corruption, by implication embracing within that topic what is in large measure its antithesis - the rule of law.

Next, we consider the definitions of corruption. We outline the concepts of regulatory rent and of rent-seeking in the business of explaining corruption. We also discuss the arguments sometimes used for justifying corruption, the damaging effects of corruption and the measures that might be taken to combat it.

1.2. Learning Outcomes

By the end of this unit, you will be able to:

- Define and explain the meaning of good governance and good policy
- Highlight the importance of civil societies
- Describe the criteria for testing good governance

1.3. Good Governance and Good Policy

Good governance can be distinguished conceptually from good policy, though the dividing line can sometimes be hard to draw. Unless a line is drawn, consideration of governance becomes simply a consideration of any elements of policy, and the question of 'governance for development' becomes the same as government policy for development. So, we attempt a distinction as follows:

The policy is the outcome of a series of decisions on what constitutes a problem, what the possible solutions are, and how to implement the preferred solutions (Parto, 2005). The policy is what a government decides explicitly to do, including its executive and legislative decisions. Issues such as climate change, energy and healthcare are at the forefront of major policy issues the world faces today. Public policy is put in place to serve citizens' needs and uphold the collective morals of a society. A good public policy seeks to define issues and implement strategies that will produce measurable and positive results for the general public. Effective public policy will support democratic institutions and processes, serve justice, encourage empathetic and active citizenship, and solve problems efficiently and effectively without causing a political rift. Thus, a successful policy is both the execution of a good policy (positive, measurable outcome) and good politics (bipartisanship).

Governance means the process of decision-making and the process by which decisions are implemented (or not implemented) (UNESCAP, nd). Governance can be used in several contexts such as corporate governance, international governance, national governance and local governance. Governance concerns the workings of the mechanisms by which government operates: through which policy decisions are implemented, laws enforced, and recognized rights upheld. However, the term is also extended to cover the nature of those recognized rights. It is in such areas as this last-over the nature of the laws, explicit or implicit, that define people's rights-that distinguishing between good governance and good policy becomes especially difficult. Some laws are products of current policy, and some are elements in the way government works, and the categories overlap.

Good governance is a measurement scale on how public institutions conduct public affairs and manage public resources to guarantee the realization of human rights in a manner free of abuse, corruption and due regard to the rule of law (Emeh, et al, (2019). Governance in a particular instance may be considered good instrumentally, that is for what it achieves – for example, economic growth and reduction in material poverty - or good in itself, because it treats people impartially, predictably, tolerantly, responsively, as on the whole people desire to be treated, and as – to state a (surely) widely held judgment of value-they ought to be treated. Whether or not governance is to be rated only instrumentally, and if so with what ends in view, has a bearing on the criteria on which it should be judged. Recent studies distinguishing between 'thin' and 'thick' concepts of the rule of law reflect this distinction. If the test is the extent to which government promotes growth in income per head, then it may be enough that the law should effectively defend property rights, so reducing the uncertainty and other transaction costs of productive investment and supporting economic growth. If, however, the test is the contribution that government makes to development in the broadest sense of enhancing human freedom and capabilities, this inevitably involves the distribution as well as the growth of income; the public provision, or shoring up, of certain essentials of social welfare; and the enforcement of what are agreed under international conventions to be human rights.

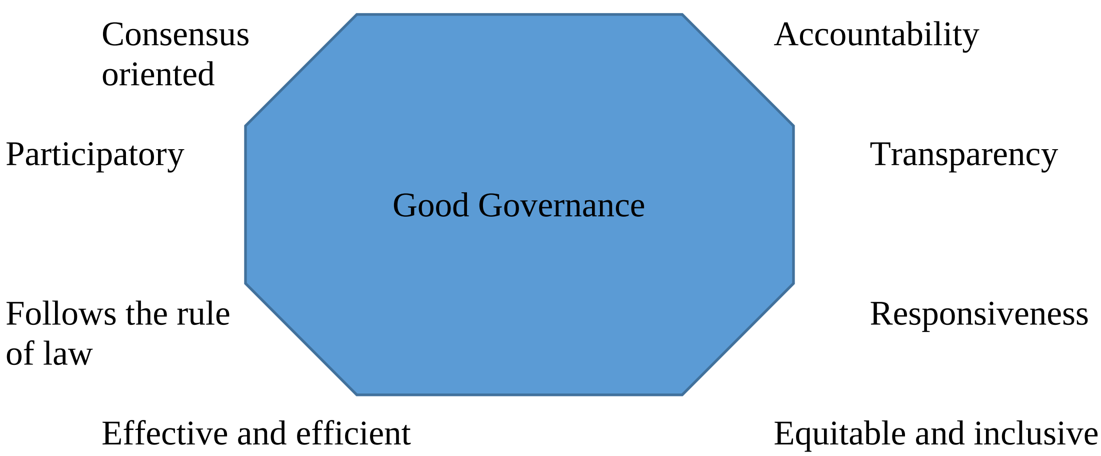

Figure 1: Characteristics of good governance

Source: UNESPA (nd).

Figure 1 shows the 8 major characteristics of good governance. It is participatory, consensus-oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive and follows the rule of law. It assures that corruption is minimized, the views of minorities are taken into account and the voices of the most vulnerable in society are heard in decision-making. It is also responsive to the present and future needs of society.

Self-Assessment Exercises 1

1. What is governance?
2. Explain the term good policy
3. List the five characteristics of good governance

1.4. Importance of Civil Society

Civil society has been broadly defined as the "area outside the family, market and state" (WEF, 2013 as cited in Cooper, 2018). The African Development Bank argues that civil society is the voluntary expression of the interests and aspirations of citizens organised and united by common interests, goals, values or traditions and mobilised into collective action (AfDB, 2012). Civil society covers the organizations, institutions, and practices that are not coercive and at the same time not motivated by the pursuit of the private individual or corporate profit of those engaged in them. The importance of civil society in social and economic development, like that of the quality of government, has also been recognized explicitly since the 1990s. Its role may be seen as analogous to that of the market and government. Each of the three represents a mode of organization that depends on harnessing, potentially for the common good, certain fundamental human propensities. These are respectively: the exercise of rational and flexible activity for one's own and one's family's benefit, which is the foundation for the market; the readiness to accept certain kinds of rules. On the part of certain people, a readiness or desire to exercise authority, which between them form the base for government; and what may be called active humanity, namely a propensity for accepting responsibility in the interest of others, for trust and trustworthiness, and for creation: which three elements constitute the seedbed of what we call civil society. It is the mobilization of these three sets of propensities that gives the three vital organizational ingredients for living together harmoniously and efficiently in large integrated societies. Civil society encompasses a spectrum of actors with a wide range of purposes, constituencies, structures, degrees of organisation, functions, size, resource levels, cultural contexts, ideologies, membership, geographical coverage, strategies and approaches (AfDB, 2012). Civil society sustainability may be defined as the capacity and capability of organized and loosely formed citizens associations and groupings to continuously respond to national and international public policy variations, governance deficits, and legal and regulatory policies through coherent and deliberate strategies of mobilizing and effectively utilizing diversified resources, strengthening operations and leadership, promoting transparency and accountability, and fostering the scalability and replicability of initiatives and interventions (VanDyck, 2017)

Self-Assessment Exercise 2

1. Discuss the importance of civil societies in a country.

1.5. Test of Good Governance

The World Bank, in its Worldwide Governance Indicators, judges governance on six characteristics: Voice and accountability, Political stability and absence of violence, Government effectiveness, Regulatory quality, Rule of law and Control of corruption. The true test of 'good' governance is the degree to which it delivers on the promise of human rights: civil, cultural, economic, political and social rights (United Nations Human Rights, n.d). The key question is: are the institutions of governance effectively guaranteeing the right to health, adequate housing, sufficient food, quality education, fair justice and personal security? In other words, to be judged good in the way it works, the government should:

- be based on institutions that keep it responsive and responsible to the populace;
- be able to maintain the peace and implement its decisions;
- attempt to regulate only what it can effectively and usefully regulate and do so in ways that are advantageous to the population;

- be subject consistently to rules of justice and public interest rather than being available at discretion for the benefit of any of those in power and authority.

The six characteristics are causally linked so that the discussion of good governance revolves around control of corruption and is closely connected with the rule of law. Hence, each is to some degree a condition of the other. For instance, if corruption is extensive, the effective rule of law becomes impossible. Conversely, an arbitrary government which is unchecked by law, makes corruption extremely likely and not easy to identify as a prelude to eradicating it.

The issue of 'voice and accountability requires not only popular elections for those in power (and a degree of activity from civil society) but also transparency and openness in decision-making, and elections that are subject to the law and substantially free from corruption. Unenforceable regulations, or those that are not respected by the public for their manifest usefulness, greatly increase the likelihood of corruption, and, like any attempt of the government to undertake more than it can perform, undermine its effectiveness in doing what it needs to do. It is also virtually a precondition of all the other desirable characteristics that a government should be able to keep the peace throughout its jurisdiction, and that each layer of government should be able to have its lawful decisions on specific tangible action implemented.

If 'development' is taken to include expanded individual freedoms and immunities, then the type of governance conducive to development should also be biased by its institutions to uphold human rights. Upholding human rights involves, first, strictly limiting state violence, and second, defending the weak from the strong, the poor from the rich, and the minorities from the majority. This entails the rule of law. But, a law that of course impartial in its administration tends to be biased in its content in favour of the poor and socially weak, because - as with the avoidance of corruption - law, political rhetoric, and the preponderance of world ethical judgments, largely favour this human-rights objective, the circumstances that foster it will overlap considerably with those discouraging corruption. The issue of corruption in its broadest sense - its causes and effects and the means for controlling it- is so closely tied to the other criteria of good governance. Its apparent importance in the economic systems of many developing countries and its ostensible bearing on economic growth and the reduction of poverty should not be ignored. Hence, good governance should relate to the political and institutional processes and outcomes that are necessary to achieve the goals of development.

Self-Assessment Exercises 3

1.	What is good governance?
2.	Identify the indicators of good governance

1.6. Summary

In this unit, we discussed that governance in a particular instance may be considered good instrumentally, that is for what it achieves. It often emerges as a model to compare ineffective economies or political bodies with viable economies and political bodies. Good governance is an indeterminate term used in the international development literature to describe how public institutions conduct public affairs and manage public resources. It includes full respect for human rights, the rule of law, effective participation, transparent and accountable processes and institutions, and an efficient and effective public sector. The concept of civil society was also discussed in this unit.

1.7. References/Further Readings/Web Resources

African Development Bank. (2012). *Framework for Enhanced Engagement with Civil Society Organisations.* Abidjan: African Development Bank.

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Cooper, R. (2018). What is Civil Society, its role and its value in 2018?

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1.8 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). Governance means the process of decision-making and the process by which decisions are implemented. Governance concerns the workings of the mechanisms by which government operates: through which policy decisions are implemented, laws enforced, and recognized rights upheld.

2). A good public policy seeks to define issues and implement strategies that will produce measurable and positive results for the general public. Effective public the policy will support democratic institutions and processes, serve justice, encourage empathetic and active citizenship, and solve problems efficiently and effectively without causing a political rift.

3). Characteristics of good governance are participatory, consensus-oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive and following the rule of law.

Answer to SAEs 2

1). The importance of civil society in social and economic development, like that of the quality of government, has also been recognized explicitly since the 1990s. Its role may be seen as analogous to that of the market and government. Each of the three represents a mode of organization that depends on harnessing, potentially for the common good, certain fundamental human propensities. These are respectively: the exercise of rational and flexible activity for one's own and one's family's benefit, which is the foundation for the market; the readiness to accept certain kinds of rules. On the part of certain people, a readiness or desire to exercise authority, which between them form the base for government; and what may be called active humanity

Answers to SAEs 3

1). Good governance is a measurement scale on how public institutions conduct public affairs and manage public resources to guarantee the realization of human rights in a manner free of abuse and corruption and with due regard to the rule of law. Good governance requires full protection of human rights

2). Good governance indicators are Voice and accountability, Political stability and absence of violence, Government effectiveness, Regulatory quality, Rule of law and Control of corruption.

UNIT 2 CORRUPTION AS A DEVELOPMENTAL ISSUE

Unit Structure

2.1. Introduction
2.2. Learning Outcomes
2.3. Definition and Classification of Corruption
2.4. Different Forms of Corruption
2.5. Nature of Corruption
2.6. Measurement of Corruption
2.6.1. Transparency International's Three Sets of Ratings
2.7. Summary
2.8. References/Further Readings/Web Resources
2.9. Possible Answers to Self-Assessment Exercises (SAEs)

2.1 Introduction

Corruption demoralizes the government and weakens the whole endeavour of policy formulation and implementation. Hence, in this unit, we will discuss corruption as a global developmental issue. A lot of definitions can come to your mind for this term corruption based on what is happening in our country Nigeria. It comes in form of bribery, extortion, embezzlement, misappropriation of public funds, etc. We will also discuss how corruption is measured drawing insight from the different international agencies such as Transparency International, Corruption Perception Index and Global Corruption Barometer.

2.2. Learning Outcomes

By the end of this unit, you will be able to:

- Define and explain the meaning of corruption

- Identify the different forms of corruption
- Describe the nature of corruption
- Highlight the different measures of corruption

2.3 Definitions and Classifications of Corruption

What do you understand by the term corruption? The issue of corruption is attracting a lot of interest in the global economy due to its damaging effect on growth and welfare. It is much more common on the whole in poorer countries and worst in failed states. Though its connection with low-income countries might, on a priori reasoning, be because of the accusations that governments have failed due to corruption.

Corruption has been defined in many different ways, each lacking in some aspect (Tanzi, 1998). Although it may be difficult to describe, there are narrow and wide definitions of corruption. The narrow definition would confine it to bribery, which is the form of malpractice with which ordinary people have the most contact in their day-to-day lives. Senior (2006) defines corruption in this narrow sense, saying that it requires 'five conditions that must all be satisfied simultaneously': Corruption occurs when a corrupt person (1) covertly gives (2) a favour to another or to a nominee to influence (3) action(s) that (4) benefit them or a nominee, and for which the corrupt person has (5) authority. The favour must be a positive good or service, to exclude from his definition extortion and blackmail. Much of what people mean when they complain of government corruption is indeed bribery, corruption in this narrow sense. Senior's definition deliberately includes comparable dishonesty perpetrated by officials of private bodies such as corporations, which no doubt breeds similar social attitudes.

The term 'corruption' is also used more widely to cover virtually any misuse, or unlawful use, of government power in the interest of particular individuals or groups. Transparency International (TI) defines corruption using Corruption Perceptions Index simply as 'the abuse of public office for private gain' (TI, 2008). The World Bank defines it as 'the abuse of public power for private benefit' (Tanzi, 1998). These, unlike Senior's definition, include not only forms of financial malpractice that go well beyond bribery, but also the improper use or threat by the state and its officials, of violence or other harm. However, if we are to consider corruption only as the abuse of public office, we shall ignore practices that entail cheating, theft, or misdirection in which the parties on both sides are non-government entities, and also misdemeanours in which no politician or official is culpable; and in these respects, the definition would be narrower than Seniors.

Self-Assessment Exercises 1

1. Define and explain the term corruption.
2. Identify ways through which corruption is perpetuated

2.4. Different Forms of Corruption

Items in the following list are adapted from those in Caiden (1988) and Johnson and Sharma (2004) with the exclusions mentioned above and some amalgamations. Official corruption may be taken to cover:

- Bribery (accepting or demanding gifts for official services, favours, or influence)
- Kleptocracy (stealing by politicians or officials of public funds or property)
- Misappropriation (any other illegal use of public funds or property)
- Illegal use of coercive power (intimidation, torture, unlawful detention)
- Perversion of justice by police, judges, or other officials
- Nepotism and cronyism in official appointments and contracts
- Clientelism and patronage (biased political decisions made to keep a segment of popular or influential support)
- Concealment to protect against maladministration and malpractice
- Links of officials or politicians with organised crime
- Electoral manipulation (falsification of results, gerrymandering, voter intimidation)
- Misuse of inside information obtained through official channels

- Tax evasion, and facilitation of tax evasion, through the use of official position
- Illegal use of surveillance for private purposes.

There is some overlap among these categories; not all are equally bad while forms of corruption are quite legal. There may be considerable favouritism (cronyism) in the award of government contracts and franchises, which is not against any law even though it may be costly for the country. Also elected politicians will be expected to seek some favours for the districts or cultural groups that elected them, and that will often be completely legal and not subject to wide disapproval, especially as it will probably be fairly open. Other practices on the list, however, can seriously undermine the function of the state as a benevolent institution, and risk-reducing it to the level of an association for plunder.

It will be seen that corruption in this broad sense covers a great variety of activities. One distinction is between micro and macro corruption. On the one hand, there is the more or less petty corruption that ordinary people meet in their daily lives and that constitutes a highly tangible burden. This accounts probably for all or most of the corruption recorded on TI's Global Corruption Barometer. On the other hand, there is the monstrous plunder of public assets, on the part of heads of government which may greatly affect people's lives but is often largely invisible to the general public until either the big man is toppled or a disaffected intimate investigator brings it to light. In between the micro and macro scale corruption, is the fairly large-scale bribery of officials, including some below the very highest, which often goes with the award of contracts for big public projects. Tanzi (1998) lists seven distinctions among forms of corruption, namely:

1. ... 'petty'. . . or 'grand' . . . [micro or macro]
2. cost-reducing (to the briber) or benefit-enhancing
3. briber-initiated or bribee-initiated
4. coercive or collusive
5. centralized or decentralized
6. predictable or arbitrary
7. involving cash payments or not.

Self-Assessment Exercise 2

1. Describe the different forms of official corruption

2.5. Nature of Corruption

(i). Basis for bribery of officials: the idea of regulatory rents

The term rent in economics refers to the returns to the holders of property simply because it is their property, independently of any rewards for the effort, saving, or risk-taking on their part. Regulation that restricts, whether, for good or bad reasons, any form of gainful activity raises its market price and therefore its value to whoever engages in it. This potential gain in value to the person who can engage in the restricted activity is described as a regulatory rent. Area planning – deciding who can build or operate what were – and allocation of quotas on foreign trade or capital movement are examples. Officials who determine the result of planning applications or who allocate import quotas, and those whose job is to enforce planning decisions or trade restrictions, have a source of rent at their disposal for which members of the public may be prepared to pay. Police who de facto have the discretion to enforce, or not to enforce; legal penalties to recover or not to recover stolen property for its owners; or (with impunity) to fabricate offences, have similar assets of value that they can sell. Corrupt judges in civil cases in which large amounts are at stake may have some big rents at their disposal. The currency of the concept of regulatory rents in this sense is attributed to Anne Krueger (1974).

It is an entirely reasonable principle of policy that the value of any regulatory rents should accrue not to the officials who administer them but to the community through central or local governments. One important school of economic-policy thought, the followers of Henry George (1839-1897) holds that the same principle ought to be applied to the rents due to possession of all the 'gifts of nature' - land and other natural resources - on grounds implying that this is both fair and efficient. This rule is implemented if such payments as fines and taxes on trade are treated as government revenue. There are analogous ways of dealing with other regulatory rents through devices such as auctioning-for state revenue-trade and capital-export quotas and building permits, and increasing local site taxes on defined areas when, and to the extent that, regulatory changes have increased their value.

(ii) Persistence of corruption (and honesty)

Some writers have tried to explain why, as they see it, a routine practice of bribery in some societies and of honesty in others seems to be self-sustaining (Mishra, 2006). To simplify: Mishra's explanation depends on people's response to net rewards (material and also psychic) given two effects. First, the more corrupt people there are, the greater are the net expected material rewards to any official or member of the public from corrupt behaviour (because the less is the risk of prosecution or losing reputation, and the greater is the prospect or ease of finding a corrupt counterpart). Second, the more corrupt people there are, the more corruption tends to become the social norm, and the less the psychic (and perhaps reputational) penalties. On both grounds there will be a tendency for any initial movement towards, or away from, corruption, once it passes a certain point, to generate positive feedback and hence sustain itself. So there may be two potential stable-equilibrium positions for any society: one relatively corrupt, one relatively uncorrupt. Policy measures increasing the size of penalties or the likelihood of being detected and if detected penalized, will not necessarily be irrelevant, but, with established practices of corruption and ethical norms permitting it, measures such as this will face considerable obstacles to a decisive shift out of the vicious circle that maintains the corrupt equilibrium.

Surveys reported by Miller (2006) in four 'transitional' European countries suggested a gap between people's normative views about corruption (which were predominantly unfavourable) and their readiness nonetheless to offer, demand, pay or receive, bribes. But the normative views were probably not irrelevant. The countries of the four with the most and least unfavourable views were also those with the least and most reported readiness respectively to engage in bribery. However, one of Miller's inferences from these results was that attempts at moral argument or indoctrination against bribery were unlikely to be effective in seriously reducing it in these countries - since it was already widely disapproved, even by people who felt obliged, or were sufficiently tempted, to practice it.

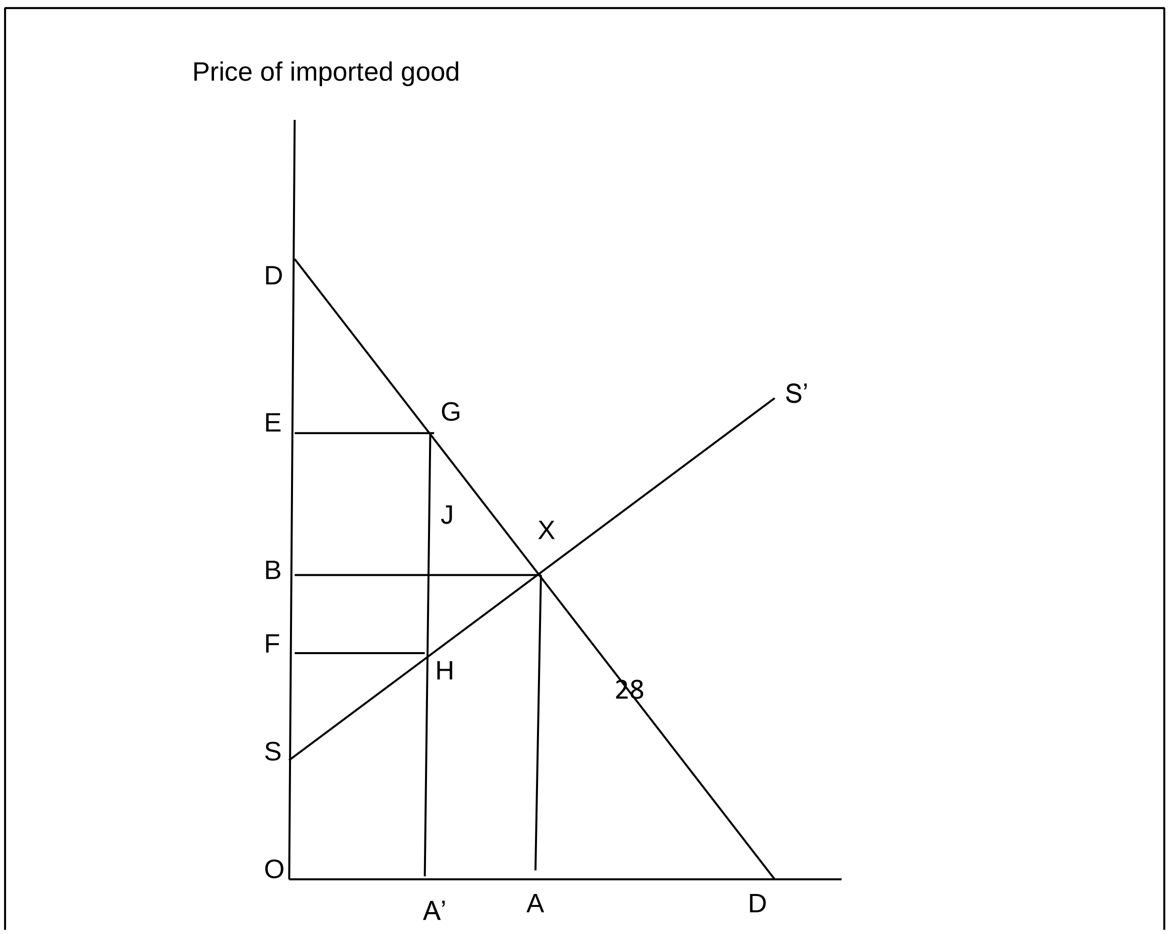

Figure 2. Regulatory rent

In Figure 2, the vertical and horizontal axes represent the price and quantity of an imported good. *DD* and *SS* are demand and supply functions for the good in the domestic market in the absence of restriction. Then, *OA* and *OB* are the free-market equilibrium quantity and price. Suppose import purchases of the goods are limited by regulation to

OA. The quota raises the buyer price to *DE* and lowers the seller price to *OF*. The area *EGHF* represents the regulatory rent. A trader who is allocated the quota free of charge, as the only one allowed to import the good, can buy the good at a price *OF* and sell it domestically at a price *OE*. Simply by being allocated the quota, he can make gain *EGHF*, the regulatory rent. If instead the state auctions the quota, the regulatory rent accrues to the public finances.

Self-Assessment Exercise 3

1. Describe what is meant by regulatory rent
2. Why does corruption persist in a country?

2.6. Measurement of Corruption

Given the many forms and the often secret nature of corruption, there are difficulties in measuring it meaningfully, particularly in giving a single rating for the degree of corruption for each country. Transparency International (TI), however, a non-profit organization centred in Berlin with national branches across the world, attempts to give each year some critical indicators of corruption on global and national scenes through three sets of summary information, derived from questionnaire-based surveys. The three reflect respectively the judgments of (foreign and national) business people and analysts; the experience of ordinary citizens; and the behaviour of potential bribe-payers in transnational transactions. TI also publishes information on corruption measurement and on research relating to factors affecting corruption and the effectiveness of attempts to combat it. Other surveys (Tanzi, 1998) are provided by the Global Competitiveness Report (Geneva); Political and Economic Risk Consultancy (Hong Kong); Political Risk Services (Syracuse, NY); and the World Bank.

2.6.1. Transparency International's Three Sets of Ratings

Transparency International (TI) is a German registered association founded in 1993 by former World Bank employees to take action to combat global corruption with civil societies and to prevent crime arising from corruption. Its notable publications include:

(i). The Corruption Perception Index (CPI) is described by TI (2008) as a composite index, a poll of polls, drawing on corruption-related data from expert and business surveys carried out by a variety of independent and reputable institutions. It reflects the perception of experts such as domestic and international business executives, financial journalists and risk analysts. The CPI focuses on the public sector and evaluates the degree of corruption among public officials and politicians. The CPI measures rates countries based on their perceived level of corruption, on a scale from 0 (highly corrupt) to 10 (clean). The index was first used in 1995 and subsequently published annually. Although, it was initially criticized for poor methodology and unfair treatment of developing nations, while also being praised for highlighting corruption and embarrassing governments (Chaikin, 2009).

(ii). The Global Corruption Barometer (GCB) published by Transparency International is concerned with attitudes toward and experiences of corruption among the general public. It seeks to answer questions such as how often, how much per year, to what groups of officials, and for what, the average person in any particular country pays bribes. It surveys 114,000 people in 107 countries on their view of corruption. Unlike the CPI which uses perceived expert opinions, this survey directly asks the population whether they have paid a bribe to a public body during the last year.

(iii). The Bribe Payers Index (BPI) starting in 1999 and ending in 2011 ranked nations according to the prevalence that a country's multinational corporation would offer bribes (Chaikin, 2009). That is, it focuses on the propensity of firms from leading export countries to bribe abroad - indicating the "supply-side" of corruption'. The ranking is calculated from responses by businesses to two questions on the World Economic

Forum's Executive Opinion Survey. The BPI ranking is the average score, with higher scores suggesting a lower likelihood of using bribery.

Although, due to the secret nature of corruption, many of the measures are just people's perceptions of corruption- perceptions of its incidence and perception of its nature (Graycar, 2017).

Self-Assessment Exercises 4

1. Identify the Transparency International three set of corruption rating.
2. Discuss the Corruption Perception Index as an index for measuring corruption

2.7 Summary

In this unit, we discussed that corruption is a global disease which hinders development in every aspect. We also looked at the different meanings of corruption, forms and measurement of corruption and the reason why some government officials are involved in bribery. In conclusion, we assert that if corruption is eradicated in an economy, there will surely be some level of development in that economy.

2.8 References/Further Readings/Web Resources

Aidt, T. S. (2016). Rent-seeking and the economy of corruption. *Constitutional Political Economy,7,* 142-157. https://link.springer.com/article/10.1007/s10602- - 9215-9#citeas

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2.9 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). The term corruption involves any misuse, or unlawful use, of government power in the interest of particular individuals or groups. It is the abuse of public office for private gain. It includes not only forms of financial malpractice that go well beyond bribery but also the improper use or threat by the state and its officials, of violence or other harm. corruption is broadly considered as the abuse of public office.

2). Ways through which corruption is perpetuated are when a person covertly gives a bribe. When a favour to another or a nominee to influence action(s) that benefit them or a nominee, and for which the corrupt person has authority.

Answers to SAE 2

1). The different forms of corruption are stealing by politicians or officials of public funds or property; Misappropriation of public funds or property; illegal use of coercive power in form of intimidation, torture and unlawful detention of a person; nepotism by favouring relatives and friends in official appointments and contracts; linking of officials or politicians with organised crime; Electoral manipulation through falsification of election results and voter intimidation; Tax-evasion, and facilitation of tax evasion, through the use of official position; illegal use of surveillance for private purposes.

Answers to SAEs 3

1). The term rent in economics refers to the returns to the holders of property simply because it is their property, independently of any rewards for the effort, saving, or risk-taking on their part. Regulation that restricts, whether, for good or bad reasons, any form of gainful activity raises its market price and therefore its value to whoever engages in it. This potential gain in value to the person who can engage in the restricted activity is described as a regulatory rent.

2). The persistence of corruption depends on people's response to net rewards (material and also psychic) given two effects. First, the more corrupt people, the greater the net expected material rewards to any official or member of the public from corrupt behaviour (because the less is the risk of prosecution or losing reputation, and the greater is the prospect or ease of finding a corrupt counterpart). Second, the more corrupt people there are, the more corruption tends to become the social norm, and the less the psychic (and perhaps reputational) penalties. On both grounds there will be a tendency for any initial movement towards, or away from, corruption, once it passes a certain point, to generate positive feedback and hence sustain itself.

Answers to SAEs 4

1). The Transparency International Ratings: (i) The Corruption Perception Index (CPI); (ii) The Global Corruption Barometer (GCB) and (iii) The Bribe Payers' Index.

2). The Corruption Perception Index (CPI) is described as a composite index, a poll of polls, drawing on corruption-related data from expert and business surveys carried out by a variety of independent and reputable institutions. The CPI focuses on the public sector and evaluates the degree of corruption among public officials and politicians. The CPI measures rates countries based on their perceived level of corruption, on a scale from 0 (highly corrupt) to 10 (clean). The index was first used in 1995 and subsequently published annually. Although, it was initially criticized for poor methodology and unfair treatment of developing nations, while also being praised for highlighting corruption and embarrassing governments.

UNIT 3 RATING OF CORRUPTION ACROSS THE WORLD

Unit Structure

3.1. Introduction

3.2. Learning Outcomes

3.3. Rating of Corruption

- 3.3.1 Global Corruption Barometer (GCB) rating
- 3.3.2. Corruption Perception Index (CPI) rating

3.4. Reasons for Corrupt Practices in Developing Countries.

3.5. The Effects of Corruption on an Economy

3.6. Summary

3.7. References/Further Readings/Web Resources

3.8. Possible Answers to Self-Assessment Exercises

3.1 Introduction

Transparency International (TI) has published the Corruption Perceptions Index (CPI) since 1995, annually ranking countries by their perceived levels of corruption, as determined by expert assessments and opinion surveys. The CPI generally defines corruption as the misuse of public power for private benefits. However, corruption across the world emanated through; the emergence of the political elite who believe in interest-oriented rather than nation-oriented programmes and policies, and artificial scarcity created by the people with malevolent intentions wreck the fabric of the different economies. Corruption is caused because of the change in the value system and ethical qualities of men. This unit will highlight the effects of corruption and different global rating corruption by the Transparency International

3.2. Learning Outcomes

By the end of this unit, you should be able to:

- Highlight the ratings of countries according to corruption levels using the Global Corruption Barometer (GCB) and Corruption Perception Index (CPI)
- Enumerate the reasons for corrupt practices in developing countries.
- Explain the effects of corruption in an economy.

3.3. Rating of Corruption

3.3.1 Evidence from the Global Corruption Barometer (GCB) on petty bribery

The GCB surveys of 2006 and 2007 show the pervasiveness in ordinary people's lives of the demands for bribes as conditions for receiving basic services or avoiding (just or unjust) penalties or adverse judicial decisions. The poor, as expected, were hit hardest. The worst of the 'services' across the world in both years was the police. In 2006 17%, and 2007 25%, of respondents who had had dealings with the police had been asked for a bribe: in 2006 the figure was about 55% in Africa; 33% in Latin America; 15-20% in each of South and East Europe, Asia-Pacific, and the region comprising Russia, Ukraine and Moldova; and small percentages in North America and the EU and Western Europe. Second-worst service overall in 2007 was the judicial system. Other sectors that were large bribe-demanders were registry and permits; health; education; utilities; and taxation. Across the regions, there were differences in the sectors where bribe demands were prominent. In the EU and Western Europe, it was medical services; in Africa and Russia-Ukraine-Moldova, both medical services and education; in Latin America, Asia-Pacific, and North America, bribery was especially prevalent in the courts (it is not clear from the source whether these sectors were the next most prevalent in all the regions concerned after the police) (TI, 2007; 2008).

3.3.2. Evidence from the CPI on the prevalence of corruption across countries

The countries' scores and rankings on the 2007 CPI show that three countries came out best, and they are; were Denmark, Finland, and New Zealand, with Singapore and Sweden next. The two worst were Myanmar and Somalia. There is a strong tendency for the high-income OECD countries to come out relatively well. Also, there is a tendency for those near the very bottom of the list to be more or less failed states, where any central government has limited control and there may be, or have recently been, large parts of the country outside its control altogether. Among the high-income OECD countries, Greece is the lowest-ranking, at number 56 out of 180. Of middle-income countries, Chile is the highest at 22nd. Botswana is the highest in Africa at 38th. In the Asia Pacific, Japan, Malaysia and the 'Four Tigers' are all in the top 43, with Singapore 4th equal (in company with the Nordics), Hong Kong 14th, and the two lowest of those six, Malaysia and South Korea, roughly on a par with Italy. However, rapid growth is no guarantee that a country scores reasonably well on corruption. China, with for long apparently the fastest growing economy in the world, was only 72nd equal on the CPI (together with India, Brazil and Mexico), scoring 3.5 while the least corrupt registered 9.4. Yet, though the positive relationship of CPI score with income level is very imperfect, it is inescapable, and, as a rough generalization, it seems to dominate over any independent relationship of the score with the region of the world.

Self-Assessment Exercises 1

1. Describe the Global Corruption Barometer on Petty bribery
2. What is the full meaning of CPI?
3. What is Nigeria's rating in terms of corruption in 2021, using CPI?

3.4 Reasons for Corrupt Practices in Developing Countries.

If we presumed, purely for the sake of argument, that it was the character of the society – the income level and the other features that tend to go with it, the typical nature of 'developing' as against 'developed' countries – that at least partly determined the prevalence of corruption, we could postulate the following reasons why this might be so. There are at least three possible reasons why a low level of income per head - or some characteristic closely connected - might favour the possibility of corruption.

First, it might be a greater residue of traditional views of power, which do not distinguish between the personal and the public rights and property of a 'big man and look to him, because of his wealth and the influence that goes with it, as a protector and object of loyalty.

Second, maybe some part may be played by the greater gap in poorer countries today between material aspiration and reality for most people.

A third plausible factor, not so obviously related either to poverty or to relics of traditional attitudes, is the fact that in poorer countries there is often a high degree of unnecessary regulation with inadequate capacity for enforcement so its main impact is often as an obstacle to necessary or harmless activity and as fertile ground for arbitrary exactions.

It is a partly separate question of whether a low growth rate of GDP can be expected to encourage corruption. Mishra (2006) speculates that the process of economic growth may act against 'collusive behaviour' because it can raise the opportunity cost of resources devoted to collusion. To put it another way, the changes likely to be associated with economic growth may make production more rewarding to time and effort for talented people concerning regulatory rent-seeking.

Self-Assessment Exercise 2

1. What are the reasons why corruption exist more in poorer countries?

3.5. The Effects of Corruption on an Economy

There are various ways of looking at the ill effects of corruption. Some of them are largely alternative ways of seeing others. They do not all denote mutually independent effects.

The following list is informed in large part by Cartier-Bresson (2000) and by Tanzi (1998).

i. Loss of revenue and hence reduction of the state's capacity for high-priority activity.

ii. Inefficiency in official decisions including appointments and award of public contracts.

iii. Inefficient and unnecessary levies on useful productive activity.

iv. Distortion of public spending towards the kinds of projects and techniques in which bribery and overcharging are easy and profitable. There are likely to be too many capital projects at the expense of recurrent provision and maintenance; a preference for 'custom-built, high-tech equipment' regardless of the optimum choice of techniques; and distortion of sectoral priorities, for example, away from education and towards defence (Cartier-Bresson, 2000, citing evidence from Winston, 1979; Mauro, 1997). Mauro (1998) finds that corruption tends to reduce spending on education. There is incidental evidence that developing countries tend to spend too much - as judged on grounds of efficiency - on public investment concerning public consumption (Devarajan et at., 1996).

v. Increased inequality, especially between 'ins' and 'outs', resentment, and civil conflict. With petty bribery, it is disproportionately the poor who pay and those higher up the social ladder who benefit. Where there is any law that can be invoked against bribery, wealthier people are the ones most likely to be able to invoke it. With macro-corruption, it is only those near the top who make the large killings. In legal processes, whenever there is competition over who can pay the highest bribe, as in civil cases before corrupt judges, the richer parties are always likely to win. Where there are ethnic or other distinctive subsets of the population that are in any case relatively disadvantaged, corruption is likely to aggravate their grievances, increasing the risk of civil conflict which is always latent in divided societies.

vi. Reduction in the ability of the government to implement necessary regulation to correct for market failure, as over environmental externalities (Tanzi, 1998).

vii. Reduction in quality or increase in cost or both of public services and infrastructure. There are plenty of incidents of buildings that have fallen because dishonest or incompetent contractors have improperly been awarded contracts or have been allowed by corrupt officials to ignore building regulations. The alternative outcome is that the cost rises, sometimes to an extreme degree. It was estimated that, when the excess costs of corruption in Milan were rooted out by activist magistrates in what was known as the 'clean hands' operation, the cost per kilometre of the underground railway's construction fell by 57% and the cost of building the airport by 59%, and that the additional cost resulting from bribes in construction of telecom and power installations had been around 14 to 20 per cent (Senior, 2006).

viii. Profitability of rent-seeking diverting talent from useful activity.

ix. Increased taxes because of the corruption-based loss of revenue discouraging production, driving producers into the informal sector, and (through a likely switch to broad-based indirect taxes) raising the relative burden on the poor.

x. Reduction or distortion in 'the fundamental role of the government in such areas as enforcement of contracts and protection of property rights' (Tanzi, 1998).

xi. Reduction in 'the legitimacy of the market economy and perhaps also of democracy'. (Tanzi, ibid., where he asserts that the criticisms expressed in many countries against democracy and the market economy, especially in 'transitional' countries, are often motivated by the existence of corruption.)

xii. Cynicism and consequent slackness in the performance of official and unofficial duties. Corruption engenders cynicism, which makes it contagious and is likely to stifle the public spirit. It is discouraging to those officials who might be disposed to act with integrity, and to those members of the public who might be inclined to take their civic duties – official and unofficial - seriously. Public spirit is a precious resource that no country can afford to squander.

Self-Assessment Exercise 3

1. List five effects of corruption in an economy

3.6 Summary

In this unit, we discussed corruption to be like a disease in any nation of the world which hinders development in all aspects of an economy. We examined issues and levels of corruption using the Global Corruption Barometer (GCB) and the Corruption Perception Index (CPI). The reasons why countries engage in corrupt practices were also discussed, with emphasis on growing economies. The problems of corruption include reduction in revenue to an economy, inefficiency in official decisions including appointments and award of a public contract, unnecessary levies on useful productive activity, etc.

3.7. References/Further Readings/Web Resources

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3.8 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). The Global Corruption Barometer (GCB) is published by Transparency International. This survey asks the question of whether people have paid a bribe to a public body during the last year. It is concerned with attitudes toward and experience of corruption among the general public. It seeks to answer questions such as how often, how much per year, to what groups of officials, and for what, the average person in any particular country pays bribes. It has been used in surveys of 114,000 people in 107 countries regarding their views on corruption.

2). CPI means Corruption Perception Index

3). In 2021 using the CPI, Nigeria is ranked 154 out of 180 countries.

Answers to SAEs 2

1). Reasons, why poor countries generate corruption, are: (i) the character of the society – the income level and the other features that tend to go with it, (ii) a low level of income per head - or some characteristic closely connected - might favour the possibility of corruption. (iii) A situation where there is no distinction between the personal and the public rights and property of a big man, with his wealth and the influence that goes with it, as a protector and object of loyalty. (iv) Poorer countries do have a high degree of unnecessary regulation with inadequate capacity for enforcement so its main impact is often as an obstacle to necessary or harmless activity and as fertile ground for arbitrary exactions.

Answers to SAEs 3

1). The effects of corruption in an economy are

(i) Loss of revenue and hence reduction of the state's capacity for high-priority activity.

(ii) Inefficiency in official decisions including appointments and award of public contracts.

(iii) Distortion of public spending towards the kinds of projects and techniques in which bribery and overcharging are easy and profitable.

(iv) Increased inequality, especially between 'ins' and 'outs', resentment, and civil conflict. With petty bribery, it is disproportionately the poor who pay and those higher up the social ladder who benefit.

(v) Reduction in the ability of the government to implement necessary regulation to correct for market failure, as over environmental externalities.

(vi) Reduction in quality or increase in cost or both of public services and infrastructure. There are plenty of incidents of buildings that have fallen because dishonest or incompetent contractors have improperly been awarded contracts or have been allowed by corrupt officials to ignore building regulations.

(vii) Profitability of rent-seeking diverting talent from useful activity.

(viii) Increased taxes because of the corruption-based loss of revenue discouraging production, driving producers into the informal sector and raising the relative burden on the poor.

(ix) Reduction in the legitimacy of the market economy and perhaps also of democracy.

UNIT 4 CORRUPTION JUSTIFICATION

Unit Structure

4.1. Introduction

4.2. Learning Outcomes

4.3. Arguments used to Justify Corruption

4.4. Causes of Corruption

4.4.1 Causes of Corruption in Government: Some Empirical Evidence

4.5. Effects of Corruption on an Economy

4.6. Fields/Professions to Guard against Corruption

4.7. Corruption and Infringements of Human Rights

4.8. Summary

4.9. References/Further Readings/Web Resources

4.10. Possible Answers to Self-Assessment Exercises

4.1 Introduction

Transparency International (TI) published the Corruption Perceptions Index (CPI) which annually ranks countries by their perceived levels of corruption, as determined by expert assessments and opinion surveys. The CPI generally defined corruption as the misuse of public power for private benefit. However, corruption across the world emanated through the emergence of the political elite who believe in interest-oriented rather than nation-oriented programmes and policies, and artificial scarcity created by the people with malevolent intentions wrecks the fabric of the different economies. More so, tolerance of people towards corruption, complete lack of intense public outcry against corruption and the absence of a strong public forum to oppose corruption allow corruption to reign over people. In this unit, we will discuss the arguments in favour of corruption, highlight the causes of corruption among those in government and the ways to overcome corruption.

4.2. Learning Outcomes

By the end of this unit, you will be able to:

- Discuss the arguments used to justify corruption
- Highlight the causes of corruption
- Describe corruption as a cause or effect of low and stagnant income
- Identify the fields or professions in which it is important to guard against corruption.

4.3 Arguments Used to Justify Corruption

Nevertheless, a case is sometimes made for certain forms of official corruption, notably bribery and official connivance in tax evasion. Here are some examples.

(i). Bribery serves to speed official action, 'oiling the wheels of government

It is important here not to confuse an assertion that bribing may in certain circumstances be to the private advantage of the person offering the bribe from an assertion that bribery is of social value as an institution. The former of these assertions must surely be true; otherwise, bribery would not be habitual. Given the manifest inefficiency and unfairness of the effects of bribery in an economy otherwise working with reasonable efficiency, the latter can only be true if there is no other and socially better way of sparking or speeding official action, which is very much the same as saying that bribery may be of social value if (but only if) the relevant areas of government are irretrievably corrupt. That again may be true, but it does not by any means imply that bribery – and the official corruption (the susceptibility and quest for bribes) that makes it possible and drives members of the public to it – constitute a socially desirable institution, or that rigorous measures should not be taken to eliminate it. The case for the use of bribery to speed up official processes depends on supposing that they would otherwise be unreasonably and unnecessarily slow or that the queuing systems are so faulty that individual cases could easily be postponed indefinitely or regardless of any reasonable priority. There is also the suspicion that, where bribery is possible, processing will be deliberately slowed down to attract 'gifts' for speeding it up. In other words, a bribe may speed it up in an individual case because the prevalence of bribery has slowed it down across the board.

(ii) Market competition for regulatory rents will select the most productive uses and users

The reasoning here is that if, for example, the import of some industrial material is to be quantitatively restricted, (1) the most effective way of discovering which potential use and the user will employ the limited supply most productively is to find who is prepared to bid the most for it; (2) the only effective way of finding who is prepared to bid most is to see who is prepared to pay the largest bribe. Though the first step of this reasoning may well be true, the second is not. What the bribery test discovers, at best, is which dishonest person is prepared to pay most; and, because of its covert nature, it may not even achieve that. Instead of, more or less secretly, selling the permits to the highest bidder with the proceeds going to the officials who happen to be dishonest enough and in the right place at the time, the administering agency could auction them openly for public revenue. This procedure could be authorized by law; it would indeed be more socially efficient than allocating the permits arbitrarily at some official's discretion; and, because of its obligatory openness, it would at least make bribery more difficult than under any set of rules that left the disposition of the scarce supply to be determined by administrative decision. On this ground bribery - even aside from all the arguments against it on grounds of injustice and the cynicism that it generates - is at most second-best to a perfectly simple, legal, and readily applied device.

(iii). Reducing the burden of taxation will benefit the economy, and, if this happens because tax officials bend the rules, those officials are public benefactors

Following the logic of this argument, which is made by some quite respectable commentators, we should easily conclude that it would be better if there were no government revenue at all. However, if taxes on some people are reduced, either others pay more or the government is further restricted in what it can spend. Proponents of the argument are likely to claim that governments spend too much anyway and that greater difficulties in raising revenue will lead them to cut waste. Yet, whatever waste there is in government spending, there is no guarantee at all that this is what will be cut. Governments of developing countries so often seem to have not enough resources at their disposal for meeting some of the most urgent humanitarian needs and filling the most glaring gaps in infrastructure. Many of these expenditures that would seem to have a high social priority nevertheless come into the 'discretionary' category: they are the ones that can legally and politically be cut if cuts have to be made. Reducing what the governments have to spend seems very likely to reduce these critical 'developmental' expenditures. It is a nice idea that only waste and misappropriation will be hit by the diversion of public money to crooked officials, but not one borne out by experience. If the other response to the fall in revenue is followed, and a reduction in the takings from one tax as a result of corruption in its administration is met by raising the rates applied to that tax or by increasing other taxes, not only will the supposed benefit of a lower tax burden not be realized, but the upshot is also likely to be more inefficient and more unfair. If the rate on the tax concerned is increased to makeup, it will discriminate against some of those legally obliged to pay that tax (the ones who happen to be the more honest) in favour of others, If, as is likely, the taxes evaded in this way are mainly direct, the burden may instead be shifted to indirect taxes, which are likely to bear differentially against the poor.

However, the paradox that some very fast-growing 'emerging' countries, such as China and India, have reasonably high levels of corruption has at least raised doubts over the supposition of a wholly adverse influence of corruption on growth. Rock and Bonnett (2004) investigate quantitatively the possibility that corruption may be more damaging to growth in certain kinds of the economy than in others. They find that it tends at least to be less harmful in large countries than in small and believe they have found evidence that in Northeast Asia it may have been favourable to growth. Their explanation seems to depend on the supposition that China today, and Japan at an earlier stage of development, have been able to establish more predictability for investors through extralegal arrangements than would have been available in the legal economy. If correct, this would appear to go further in 'justifying' corruption in certain circumstances, even if only as a second-best, than the World Bank (WDR 1997) evidence mentioned at the end of the earlier sub-sub-section (headed 'A note: relevance of predictability') would allow. However, 'Northeast Asian countries' constitute a very small sample (presumably China, Japan and the Koreas, maybe Mongolia), and, whatever the estimated statistical significance of the findings, it is difficult to put much weight on econometric results in such a case.

Self-Assessment Exercises 1

1. Describe how bribery can speed official action in a public enterprise
2. How can market competition for regulatory rents be used to select the most productive uses and users?

4.4. Causes of Corruption

What do you think are the causes of corruption? Corruption can be a result of any or combination of the following:

i). Low wages in public service relative to wages and perks in the private sector.

ii). Lack of self-control which is manifested in many ways such as living a luxurious life beyond what one can afford; poor moral values and ethics; greediness for wealth and position; Borrowing money and being a spendthrift, etc.

iii). Weak internal control measures within the departments in form of weak leadership and supervision, lack of transparency and accountability, use of discretion without limit and control, non-existence of public complaints channels and poor monitoring of public complaints.

iv). Personal/private motivations such as when people offer bribes because they want an unfair advantage over others, people seeking bribes before they can render any services. For example, politicians who seek money to use for patronage and recognition v). Another important cause of corruption is bad incentives, such that a clerk who is not earning enough to live on is "forced" to supplement his income with bribes

vi). Corruption flourishes in any social or political setting where there are over-centralisation of the political and economic decision-making process

vii). A society that lacks well-developed social control mechanisms for the detection and deterrence of corrupt practices is bound to experience a high level of corruption (ICPC, 2015).

4.4.1 Causes of Corruption in Government: Some Empirical Evidence

Senior (2006) tested across countries their perceived levels of corruption – as measured by the countries' rankings on TI's Corruption Perception Index (CP1) – against various economic and non-economic characteristics of the countries concerned. He found that low levels of perceived corruption were significantly associated (in several bivariate or multivariate regressions) with a high prevalence of ethical standards (personal honesty) in the community, high degree of press freedom, high respect for property rights, low level of regulation, little informal-sector activity, and high GDP per head – all as he expected – but also, unexpectedly, with low levels of what he calls religiosity (measured by the prevalence of regular attendance at public worship) and high levels of government intervention (this last in apparent conflict with findings made by others). Seven other characteristics tested did not give significant results. The precise meaning of the variables used is given in the source.

Brunetti and Weder (2003) also find a negative relationship between corruption and press freedom. With the use of instrumental variables, the study supports the view that at least part of the connection runs from press freedom to lower corruption.

World Bank evidence (WDR 1997) shows the extent of corruption positively related to the extent of market distortion (essentially state intervention in the price system), and negatively to the predictability of the judiciary, the ratio of civil-service wages to manufacturing wages, and to the extent to which recruitment and promotion in the civil service are merit-based. Given the presumption and evidence that the incomes of tax administrators (on grounds both of differential competence and pecuniary advantage) will have a negative relationship to their propensity to corrupt collusion with taxpayers, UI Haque and Sahay (1996), faced with evidence of declining trends in real public-sector wages in several developing countries, use a priori reasoning to argue that there will be an optimum combination of tax and wage rate for a country to maximize, other things equal, its fiscal balance, and that departures from this optimum by cutting wages in the revenue service will reduce the balance.

It does not necessarily follow of course that any causation is entirely from the other characteristic tested to corruption. We consider below the question of the direction of the relationship with income. For most of the other characteristics among those mentioned in the three sources are just cited as showing significant relationships, however, it seems quite reasonable to suppose that corruption is the 'explained' variable. Of these, the degree of press freedom and the extent of regulation, as well as the four identified by the World Bank, seem capable of favourable manipulation by state decisions. It is certainly plausible that corruption might be reduced by changes in these variables.

Self-Assessment Exercises 2

1. What are the factors responsible for corruption in public sector?
2. How can lack of self-control lead to corruption?

4.5. Effects of Corruption in an Economy

Who can explain how they have been affected by corruption? Corruption has impacted negatively the Nigerian economy in several interrelated ways including:

i). One important effect of corruption is a lack of trust and confidence in living (Mbaeri, 2001). Daily interpersonal relationships in social, economic, and political lives are carried on upon the foundations of trust and confidence reposed in one another. Corruption erodes these values.

ii). Corruption debases and disreputes personal integrity, it breeds mutual suspicion and in turn, makes daily living dangerous and traumatic.

iii). Corruption demoralizes peoples' zeal to demand transparency, accountability and public performance.

iv) Corruption is adverse to development by stunting growth. For instance, Nigeria is regarded as the sleeping giant of Africa, despite its numerous human and material resources.

v). It promotes widespread poverty, inequality and large-scale unemployment when resources that are meant for productive activities as embezzled or siphoned.

vi) Corruption puts financial straits on the economy when there is capital flight. Hence, the country is denied the funds needed for developmental projects.

vii). Corruption promotes inefficiency and incompetence and breeds nepotism or unhealthy rivalry in the administration of government.

viii). The spread of corruption weakens the administrative and organizational structure of the state.

ix). Corruption is a threat to National Security because it breeds all forms of vice ranging from petty theft to complicated forms of theft, mass poverty, unemployment and underemployment, youth restiveness and other forms of crime and criminality

Self-Assessment Exercises 3

1. Discuss three effects of corruption in Nigeria
2. How can corruption lead to National insecurity?

4.6. Fields/Professions to Guard Against Corruption

We may speculate that probably the most critical area for maintaining integrity is the judiciary, together with the court administration over which the judges preside. So long as the administration of justice is law-driven and impartial, there is a backstop for redressing complaints of corruption in other departments. If the courts are directed to justice (and adequately financed and staffed and free of partisan political pressures), there is hope even for reforming a corrupt police force, provided at least that there is some other strong power in government working to the same end; whereas the converse may not apply: reforming the police can probably not do much to correct unjust judges.

TI devotes its Global Corruption Report 2007 to ‘corruption in judicial systems. Among other items the publication gives in-country reports on the judicial systems of some thirty individual countries, showing a variety of deficiencies, some of which might appear fairly easily capable of correction, but also several attempts at reform more or less comprehensive, revealing some of the obstacles. Especially when it comes to reform of the judiciary, there is the dilemma expressed in the Latin saying: *Quis custodiet ipsos custodes*? Who will control the guardians? If it is vital to their function that the judges should be independent of the executive, how can a reform-minded executive restrain those that are corrupt - and, if not a reform-minded executive, who is or can be empowered and authorized to do it?

Second, in importance probably is the police, which TI's recent consumer surveys (the GCB, as mentioned above) identify across the world as the most corrupt service in the sense that it is the one that demands bribes in the highest proportion of its contacts with the public. Honest courts and police, if adequately resourced, with support for integrity from the highest levels of the executive, could surely do much to clean up the corruption in other institutions.

A further important candidate in electoral administration. It is vital for maintaining civil peace after a close election, and even a modicum of trust in the government elected, that the integrity of the body managing or overseeing elections is and is believed to be, unimpeachable. This was blatantly lacking after the Kenyan election of 2007, which led to weeks of inter-communal fighting and destruction that was ended only after international mediation. Vital, for obvious reasons implied above, to pursuing social priorities with fairness and efficiency is the incorruptibility of tax (and personal-benefit) offices.

Another characteristic and sometimes huge source of leakage of public resources is works-contract administration, which needs to be strictly bound by open-bidding procedures and to be administered in transparent ways and as far as possible to exclude the possibility of conflict of interest. The huge losses avoided by removing public-works corruption in Milan have already been mentioned.

Permit and regulatory offices are also often foci of graft and need to have similarly strict rules and conventions, to operate transparently, and as far as possible-through auctioning or otherwise – to reduce or eliminate administrative discretion.

In addition, to protect, promote, reward honest and capable public servants, and sift out the dishonest and incapable, in all departments, public-service appointment bodies and disciplinary tribunals must follow explicit rules or guidelines, act transparently, and again exclude possible conflicts of interest.

Self-Assessment Exercises 4

1. Describe the most critical field for maintaining integrity
2. Identify the fields that needs to guard against corruption in Nigeria

4.7. Corruption and Infringements of Human Rights

As we have suggested, the institutions and practices that are favourable to suppressing corruption tend also to be those favourable to the defence of human rights. This is because, in today's world, law, public rhetoric, and world public opinion, are most commonly both against corruption in most of the forms listed and for the human rights affirmed by international conventions. So administrative transparency, free comment, limitation of executive power by judicial or quasi-judicial tribunals or investigatory bodies to which there is genuinely free access - whatever makes state official decisions and behaviour public or subject to open review, and much of what checks the discretion of those in power – will be likely to further both objectives.

The field of human rights began to emerge after World War II, whereas the field of anti-corruption developed following the end of the Cold War. In the 1990s, the international community recognized the need to address and limit corruption, which they viewed as a global impediment to economic development. Moreover, it became clear that corruption undermines the full realization and enjoyment of all three generations of human rights (see, Wolf, 2018). For example, corruption offences such as bribery and embezzlement can limit access to health care, education, clean water and political participation. There is little disagreement that corruption has a detrimental impact on the protection and enjoyment of human rights and the equal access of all citizens to human rights-related goods and services.

Corruption does not only lead to violations of specific human rights but also represents a structural obstacle to the implementation and enjoyment of all human rights (UNHRC, 2015). In some cases, corruption leads to the failure of government institutions, making it more difficult for countries to develop and implement human rights frameworks properly. Corruption also makes it very difficult for States to protect important rights that may not yet be guaranteed under international law, but which are guaranteed in many national constitutions and laws, such as the right to a clean environment. For instance, if a factory regularly pollutes the air in a certain region, but authorities take no action against it because they have been bribed not to act, then environmental rights (and possibly the right to health) are violated as a result of corruption. Corruption could also have a detrimental effect on peace and security, thereby fostering conditions in which the risk of human rights violations is heightened.

Corruption hampers the human rights of all individuals in a society, but members of vulnerable groups and groups exposed to marginalization and discrimination, such as children, the elderly, people with disabilities and the poor, may suffer disproportionately from corruption. These groups are often more reliant on public goods and services, such as education and health care, and have limited means to look for alternative private services (UNHRC, 2015). They typically have fewer opportunities to participate in the design and implementation of public policies and programmes, and they lack the resources needed to defend themselves against such violations, demand their rights, and seek reparations. Another group at heightened risk of corruption-related human rights violations consists of individuals involved in efforts to investigate, report, and prosecute corruption (UNHRC, 2019). Every state must protect the rights of people belonging to groups within its territory and subject to its jurisdiction and guard against violations associated with corruption (UNHRC, 2015).

Self-Assessment Exercise 5

1. Describe the nexus between corrupt and human rights

4.8 Summary

In this unit, we discussed the reason why some people justify corruption. The elimination of corruption is in most circumstances an unqualified social good, but a thoroughly corrupt state has strong mechanisms within it tending to perpetuate the corruption so that removing it presents an enormous challenge. All available forces need to be mobilized -

within government, from overseas governments and multilateral, and civil society. With wholehearted support from the head of government, the head of the police and the head of the judiciary, a powerful investigatory agency and tribunal, a free press, active civil society, and support from the home governments of inward investors, there may be some prospect of success.

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4.10 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). It has been argued that bribery serves to speed official action by oiling the wheels of government even though bribing may in certain circumstances be to the private advantage of the person offering the bribe. Given the manifest inefficiency and unfairness of the effects of bribery in an economy otherwise working with reasonable efficiency, it could be true if there is no other and socially better way of sparking or speeding official action. The case for the use of bribery to speed up official processes depends, for instance, on a queuing system that is faulty or slow, a bribe could be used to fasten the situation. There is also the suspicion that, where bribery is possible, processing will be deliberately slowed down to attract 'gifts' for speeding it up. In other words, a bribe may speed it up in an individual case because the prevalence of bribery has slowed it down across the board.

2). Market competition for regulatory rents can be used to select the most productive uses and users, for example, if the importation of some industrial material is to be quantitatively restricted, the most effective way of discovering which potential use and the user will employ the limited supply most productively is to find who is prepared to bid high by paying the largest bribe. Instead of selling the permits to the highest bidder with the proceeds going to the officials who happen to be dishonest enough and in the right place at the time, the administering agency could auction them openly for public revenue. This procedure could be authorized by law; it would indeed be more socially efficient than allocating the permits arbitrarily at some official's discretion; and, because of its obligatory openness, it would at least make bribery more difficult than under any set of rules that left the disposition of the scarce supply to be determined by administrative decision. On this ground, bribery is at most second-best to a perfectly simple, legal, and readily applied device.

Answers to SAEs 2

1). Causes of corruption in the public sector include:

(i). Low wages in public service relative to wages and perks in the private sector.

(ii). Lack of self-control which is manifested in many ways such as living a luxurious life beyond what one can afford; poor moral values and ethics; greediness for wealth and position; borrowing, etc.

(iii). Weak internal control measures and non-existence of public complaints channels and poor monitoring of public complaints.

(iv). Personal/private motivations.

(v). Poor incentives and wages/salaries.

(vi). Over-centralisation of the political and economic decision-making process.

(vii). Lack of well-developed social control mechanisms for the detection and deterrence of corrupt practices.

2). Lack of self-control can cause corruption when individuals are living a luxurious life beyond what they can afford; when there are poor moral values and ethics; greed for wealth and position; borrowing money and spendthrift.

Answers to SAEs 3

1). The effects of corruption on the Nigerian economy include

(i). A lack of trust from investors who will want to invest in the economy.

(ii). Corruption debases and disreputes personal integrity, it breeds mutual suspicion and in turn, makes daily living dangerous and traumatic.

(iii). Corruption demoralizes peoples' zeal to demand transparency, accountability and public performance.

(iv). Corruption is adverse to development by stunting growth. For instance, Nigeria is regarded as the sleeping giant of Africa, despite its numerous human and material resources.

(v). Corruption promotes widespread poverty, inequality and large-scale unemployment when resources that are meant for productive activities as embezzled or siphoned.

(vi). The country is denied funds needed or developmental projects as a result of capital flight.

(vii). Corruption promotes inefficiency, and incompetence and breeds nepotism or unhealthy rivalry in the administration of government.

(viii). The spread of corruption weakens the administrative and organizational structure of the state.

2). Corruption is a threat to National Security because it breeds all forms of vice ranging from petty theft to complicated forms of theft, mass poverty, unemployment and underemployment, youth restiveness and other forms of crime and criminality.

Answers to SAEs 4

1). Probably the most critical area for maintaining integrity is the judiciary, together with the court administration over which the judges preside. So long as the administration of justice is law-driven and impartial, there is a backstop for redressing complaints of corruption in other departments. If the courts are directed to justice (and adequately financed and staffed and free of partisan political pressures), there is hope even for reforming a corrupt police force, provided at least that there is some other strong power in government working to the same end; whereas the converse may not apply: reforming the police can probably not do much to correct unjust judges.

2). The fields that need to guard against corruption in Nigeria are the judiciary, the police, the electoral administrators and other public institutions.

Answers to SAEs 5

1). The field of human rights began to emerge after World War II when the international community recognized the need to address and limit corruption, which they viewed as a global impediment to economic development. Moreover, it became clear that corruption undermines the full realization and enjoyment of all three generations of human rights. For example, corruption offences such as bribery and embezzlement can limit access to health care, education, clean water and political participation. There is little disagreement that corruption has a detrimental impact on the protection and enjoyment of human rights and the equal access of all citizens to human rights-related goods and services. Corruption not only leads to violations of specific human rights but also represents a structural obstacle to the implementation and enjoyment of all human rights. In some cases, corruption leads to the failure of government institutions, making it more difficult for countries to develop and implement human rights frameworks properly. Corruption also makes it very difficult for States to protect important rights that may not yet be guaranteed under international law, but which are guaranteed in many national constitutions and laws, such as the right to a clean environment.

UNIT 5 PUBLIC-SECTOR AND ENHANCING PUBLIC SECTOR PERFORMANCE

Unit Structure

5.1. Introduction
5.2. Learning Outcomes
5.3. Rationales of Public Sector Activities
 5.3.1. Macroeconomic Stabilization
5.4. Public Goods and Merit Goods
 5.4.1. Public goods
 5.4.3. Global public goods
 5.4.2. Merit goods
5.5. Enhancing Public Sector Performance
5.6. Summary
5.7. References/Further Readings/Web Resources
5.8. Possible Answers to Self-Assessment Exercises (SAEs) within the content

5.1. Introduction

Though there is a wide range of functions in which state activities may in principle be required for the sake of efficiency or equity. If the state is short on administrative competence or integrity, the best course may be to stick to the simplest methods and the most essential tasks. The development economics of the mid-twentieth century was inclined to seek salvation through government action. The implicit underlying idea was that market failure was responsible for the backwardness of the lower-income countries. Government failure had been principally at fault, and the prevailing message to governments was that they should withdraw from much of their role in economic life. The World Bank's World Development Report 1997, 'The State in a Changing World', seems to have been framed to help to resolve the conflict by examining the important economic role of government and the reasonable criteria for fixing the boundaries between the state and the private sector in particular circumstances. It then explored how the public sector's performance of its vital task might be improved, and how reforms to reshape the government for fulfilling its proper role might be engineered politically. This unit draws considerably on that analysis by discussing the basic justifications for government intervention in an economy using the public sector. The unit discusses public goods and merit goods; how to improve the performance of the public sector; and how to overcome obstacles to necessary reform.

5.2 Learning Outcomes

By the end of this unit, you will be able to:

- Enumerate the rationales of public sector activities
- Differentiate public goods from merit goods
- Describe how to enhance public sector performance

5.3 Rationales of Public Sector Activities

In the absence of specific market failures, competitive markets deliver the efficient amount of all goods and services – that is the amount which best meets people's needs and preferences, given scarce resources. Market failure refers specifically to the causes of the failure, that is problems with the mechanisms through which the market works, not the consequences of the failure to deliver a certain outcome. The public sector should only intervene in the economy when markets are not efficient and when the intervention would improve efficiency (GLA Economics, 2006).

The government may need to act in economic affairs (spending, regulating, enterprising, intervening in markets) for three classes of reasons: (i) to uphold the framework of the market economy; (ii) to correct for market failure, that is, for the sake of allocative efficiency or, in other words, to provide more abundantly the goods and services that people want or need; and (iii) on grounds of equity: that is, for the sake of fairness or the reduction of excessive poverty.

In the headings that follow, market framework and macroeconomic stabilization come under framework questions; public goods, externalities, monopolies, risk and imperfect credit markets, and imperfect or asymmetric information come under market failure; redistribution under equity; and merit goods awkwardly under a combination of equity and market failure. All the cases listed are categories of circumstances in which government intervention of some sort may in certain circumstances be necessary or at least be of some value. However, the mere fact that some form of intervention can be fitted under one of these headings by no means implies that it is necessarily beneficial, even if it is honestly and effectively pursued. Also, forms of intervention that might, with a supremely efficient government machine, be useful, may on balance harm if what they aim to do cannot be coherently implemented with the administrative system and the prevailing ethical attitudes that are actually in place. On the other hand, where there are functions for which no such potential justification – on grounds of upholding the framework, or of economic efficiency or fairness - exists, there are good reasons for the government to leave the field to 'the market' and civil society.

More so, Government has an important role in setting or reinforcing the rules under which efficient markets are possible: civil order and the enunciation and enforcement of commercial law. In this, the state generally works best by co-operating with civil society in the broad sense: reinforcing the useful elements among informal rules, habits and attitudes.

5.3.1 Macroeconomic Stabilization

The role of maintaining the value of the currency has long been recognized as a critical contribution on the part of the government to the efficient working of an economy. In the twentieth century, the function was extended to include that of keeping a stable level or growth path of economic activity and income or expenditure for the economy at large. The state has a particular role in circumstances where what is or appears to be privately beneficial to large numbers of people individually may in aggregate be harmful, as in the conditions in which runs on currencies occur, or where there are 'bubbles' in the prices of assets or waves of pessimism among investors.

Self-Assessment Exercises 1

1. Explain what is meant by market failure.
2. Highlight three reasons why the government may need to act in economic affairs
3. What is macroeconomic stabilization?

5.4. Public Goods and Merit Goods

5.4.1 Public Goods

The term public goods refers to goods which have some specific characteristics which suggest the market will be inefficient or absent. These characteristics are referred to as non-rival and non-excludable (GLA Economics 2006)

i. Non-excludability: - They are necessarily enjoyed or consumed in such a way that what is called exclusion cannot be applied. In other words, if the good is supplied at all, those unwilling to pay cannot be excluded from its benefits. So the goods cannot be financed by charging for their use.

ii. Non-rivalry: - Their consumption or enjoyment by one person does not reduce the possibility of their enjoyment by others - such that, even if those unwilling to pay are excluded, it will, at least in the short term, be socially wasteful to do so (because the extra consumer entails no extra cost).

Instances, where both characteristics apply (pure public goods), are the provision of law and order through the police and the system of justice and protection from outside attack. Another example is street lighting. The 'framework' benefits mentioned above, including macroeconomic stabilization, may also be classified as pure public goods. In all these cases the market unassisted will not do the job. It will have to be accomplished either by civil society (through consensus, which on the scale required will often be difficult to achieve in modern economies) or by the state (with the backing of coercion). Peacekeeping and protection against external attack may indeed be regarded as the original (beneficent) functions of the state. That is the main reason why people by and large have been prepared to tolerate government, despite its frequent failings.

Another instance is the provision of roads and bridges, potential users who refuse to pay can be excluded. On the other hand, unless the road or bridge is congested, the extra social cost of an additional user is often negligible. Enforcing the payment of tolls has costs including delays to road users. Some major roads could be and have been provided through the charging of tolls by private enterprise, but much of the road networks that countries today enjoy and consider essential could not be so provided without manifest inefficiencies, and without state participation, they might not be provided at all. Generally, it is taken for granted that the state provides most of the roads.

There may also be rivalry without excludability with so-called common-property goods. Examples are grazing rights on common land and irrigation water. Failing local civil society rules, of which there are many examples, some of them persisting for centuries (Ostrom, 1990). The state must regulate the use of the land to prevent its degradation, and of the water to prevent both the inefficiency and the unfairness of its excessive use by those farmers who happen to be well-placed to draw off as much as they like.

5.4.2 Global Public Goods

Mainly since 1990, it has become common to talk of global public goods, which stand in much the same relationship to individual states as public goods in the usual sense stand to individual households. They are goods that every state desires but which uncoordinated action by individual states will not deliver. Examples are keeping the peace internationally, eliminating various contagious diseases such as smallpox or tuberculosis, or meeting some of the global environmental challenges such as ozone-layer destruction or global warming. For obvious reasons, consensual coordination among states is necessary for delivering these goods. It has sometimes worked spectacularly well, as over checking ozone-layer destruction under the Montreal Protocol of 1987, and (almost) eliminating smallpox. Several consensual arrangements - agencies, treaties, clubs, and voluntary tribunals have been set up, throughout the twentieth century and even earlier, that have produced the necessary international coordination in important fields (such as over civil-aviation rules and collection of meteorological data).

Since the late 1940s the UN has run several peace-keeping operations - IS current at the end of 2006-often with very small forces on shoestring budgets, that, despite some failures, have managed to prevent fighting or preserve truces in incendiary situations across the world, often with benefits that extend well beyond the areas concerned. Yet it is quite possible that relying on coordination through consent will not be enough in important cases. There will be costs that have to be borne, and sacrifices that have to be made, by individual states (including sacrifices of insubstantial but very potent entities such as national myths). There is no overriding global government that might operate courts to settle disputes, or impose tax systems to raise revenue - impartially and with powers of enforcement. Until there is, we must rely on institutions that operate - however imperfectly - through inter-governmental consent to deliver a number of the most crucial global public goods. This must often involve voluntary acceptance by the various governments of rules and procedures under which they agree to be bound very much as if they were under an enforced law, referred to as quasi-voluntary compliance (Ostrom, 1990).

5.4.3 Merit Goods

Merit goods are more difficult to define than public goods. Public goods can be so designated by the intrinsic character of the way the service concerned is provided, whereas the classing of a benefit as a merit good has to involve a value judgment by the authority providing it. According to GLA Economics (2006), merit goods are goods where the benefit to society due to the consumption of these goods exceeds the benefit to the individual who has undertaken the consumption. An example of a Merit Good would be education since it not only generates benefits for the individual but also generates additional benefits for the society in so far as an educated individual can produce an improved productivity performance. Health services and schooling as goods provided to individuals are not intrinsically public goods. They possess both characteristics of excludability and they are also rival goods. This means that those unable or unwilling to pay can be excluded, and they use scarce resources so that one person's use of the services may reduce what is available for other people or other purposes. The main motive behind free health services and free (or even compulsory) schooling is probably a sense of fairness. This implies that the provision has in large part a distributional objective. Compulsion over education makes for a further degree of fairness, in that, if effective, it ensures that children have the benefit of schooling even if their parents would not otherwise arrange that they attended.

Free health services and free or compulsory schooling may also have an allocative objective: to secure as far as possible a healthy and suitably competent population. This may be regarded as a public good because there are common benefits arising for the whole society over and above the benefits to the individuals who are taught or treated. Hence, individuals cannot be excluded from these common benefits if they refuse to pay for them. It is probably best to regard the provision of free or subsidized medical treatment and education as having both distributional motives (in which capacity they are merit goods) and allocative motives (based on the public-good elements they deliver).

Self-Assessment Exercises 2

1. Discuss two characteristics of a public good
2. Identify two public goods provided by the Nigerian government.
3. Differentiate between a public good and a merit good

5.5. Enhancing Public-Sector Performance

The World Bank (1997) puts forward the view that an effective state should be seen as central to economic and social development, not as a direct provider of growth but as a partner, catalyst, and facilitator [emphasis ours]. It recognizes that solutions will differ widely from one country to another in response to a large number of variables. The study enumerates the potential grounds for state intervention much as we have listed them above, but where it goes beyond this standard analysis is to propose priorities among the economic tasks of government, and to suggest what might be called degrees of intensity of government involvement in the economy, with the appropriate degree depending on the capacity of the state's institutions. According to the World Bank (1997) the five fundamental tasks of the state are:

i. Establishing a foundation of law
ii. Maintaining a non-distortionary policy environment, including macroeconomic stability
iii. Investing in basic social services and infrastructure
iv. Protecting the vulnerable
v. Protecting the environment (World Bank, ibid).

The study emphasized that the best mix for fulfilling those tasks may well involve both state and the market. The study distinguishes institution-intensive from institution-light approaches to the necessary regulation by relating the choices to three main fields of regulation namely financial institutions, utilities, and the environment.

Institution-light arrangements go for simple rules that are readily enforceable legally, local regulation, public information, and adjustment of incentives, with differing variants for the three main areas of interest. In general, they avoid administrative discretion, command-and-control and reliance on supervisory authorities, which make bigger demands on administrators' competence and integrity and come into the institution-intensive category. A decade later, we might be looking for some much stronger measures on the environment than are foreshadowed here. The world may be simply obliged to apply as best it can cap-and-trade systems on greenhouse emissions, which in their administrative characteristics arguably come into the command-and-control category.

Furthermore, some of the proposed ‘light’ provisions, such as establishing incentives for bank owners and managers to maintain bank solvency, may require considerable ingenuity to devise in the first place. However, a system that thereafter maintains itself, with little need for bureaucrats’ discretion, has obvious advantages. Attempting functions that are unnecessary, such as much of the regulation of business that often goes on in developing countries, can be positively inhibiting investment and destructive to economic activity.

The World Bank study (ibid) lists three directions in which action can be taken to enhance the public sector's performance. It involves effective rules and restraints, greater competitive pressure and increased citizen voice and partnership, drawing respectively on the architecture of the state itself, the possibilities of market-type competition in what are currently government functions both within and without the boundaries of the state, and civil society. The particular classes of measure mentioned often fit under more than one of these categories. What helps to remove the incubus of corruption will largely also provide opportunities and incentives for improvement. Particular examples are avoiding ‘policy-distortion’ such as levies, subsidies, and restrictions, other than those justified by externalities. These will misdirect government, as well as private, action; protecting the independence of the judiciary; watchdogs against corruption and official oppression; merit-based recruitment and promotion in the public service; public-service pay adequate to attract able people; accountability for delivery in the public service; the suggestion is made of reorganizing departments into performance-based public agencies with specific objectives, as in New Zealand and Singapore; ending state monopolies by contracting-out, privatization, or allowing private competitors to operate alongside state enterprises; increased public information and transparency in state activities; citizen-opinion surveys; free and fair elections; participation of users of public services in their planning and monitoring; devolving power to local institutions – ‘carefully’. All to avoid contributing to inequality or macroeconomic instability, or capture of public operations by ‘vocal interest groups.

The study argues (ibid) that as well as competence, loyalty and a measure of inner or social, rather than material, motivation among public servants will be necessary. Active engagement with public involvement is perhaps becoming increasingly easy through NGOs, particularly in the developing world. For instance, in India, the proportion of respondents who said that they participated in a social organization or political party doubled between 1971 and 1996. Also, community monitoring of an innovative community health program in the state of Ceara in North-Eastern Brazil provided the basis not only for a highly successful program but also for more effective cooperation among community members on other mutually beneficial courses of action.

Self-Assessment Exercises 3

1. Highlight the five fundamental tasks of the state
2. How can communities participate in enhancing public sector performance?

5.6. Summary

In this unit, we discussed the rationale for having public sector activities in an economy and how macroeconomic stabilization can be adopted by the government to improve the economy. Public goods are goods with two major characteristics, namely non-excludability and non-rivalry. Such goods include roads, traffic lights, etc. The term merit good is any good the concerned government believes should be available to everyone in its jurisdiction or even should be consumed by everyone. To enhance public sector performance, competence, loyalty and a measure of inner or social, rather than material, motivation among public servants will be necessary.

5.7. References/Further Readings/Web Resources

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5.8 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). Market failure refers specifically to the causes of the failure, that is problems with the mechanisms through which the market works, not the consequences of the failure to deliver a certain outcome. The public sector should only intervene in the economy when markets are not efficient and when the intervention would improve efficiency.

2). The government may need to act in economic affairs for three major reasons:

(i) to uphold the framework of the market economy;

(ii) to correct for market failure, that is, for the sake of allocative efficiency or, in other words, to provide more abundantly the goods and services that people want or need; and

(iii) on grounds of equity: that is, for the sake of fairness or the reduction of excessive poverty.

3). Macroeconomic stabilization involves the role of the government in maintaining the value of the currency for the efficient working of an economy. It also includes keeping a stable level or growth path of economic activity and income or expenditure for the economy at large

Answers to SAEs 2

1). The characteristics of a public good are referred to

(i) Non-excludability: - They are necessarily enjoyed or consumed in such a way that what is called exclusion cannot be applied. In other words, if the good is supplied at all, those unwilling to pay cannot be excluded from its benefits. So the goods cannot be financed by charging for their use.

(ii). Non-rivalry: - The consumption or enjoyment by one person does not reduce the possibility of their enjoyment by others - such that, even if those unwilling to pay are excluded, it will be in the short term.

2). Some public goods include: the provision of law and order through the police and the system of justice; protection from outside attack; provision of street lighting;

3). Public goods can be so designated by the intrinsic character of the way the service concerned is provided, whereas the classing of a benefit as a merit good has to involve a value judgment by the authority providing it. The term public goods refers to goods which have some specific characteristics of non-rival and non-excludable. Examples are traffic lights and roads. Merit goods are goods where the benefit to society due to the consumption of these goods exceeds the benefit to the individual who has undertaken the consumption. An example of a merit good is education, it does only generates benefits for the individual but also generates additional benefits for society through improved productivity.

Answers to SAEs 3

1). The five fundamental tasks of the state are:

(i) Establishing a foundation of law;

(ii) Maintaining macroeconomic stability;

(iii) Investing in basic social services and infrastructure

(iv) Protecting the vulnerable

(v) Environmental protection.

2). Enhancing the public sector performance involves effective rules and restraints, greater competitive pressure and increased citizen voice and partnership, drawing respectively on the architecture of the state itself, the possibilities of market-type competition in what are currently government functions both within and without the boundaries of the state, and civil society.

Module 2: Civil Societies and Development

This module discusses the roles and potential of having civil societies in an economy. The feedback mechanisms obtained from civil societies and the four case scenarios that enhance behaviour change are also described. The specific unit topics are as follows:

Unit 1: The Roles and Potentials of Civil Societies
Unit 2: Positive Feedback Mechanisms of Civil Societies
Unit 3: Change in Behaviour: Generalizations from the Four Cases

Unit 1: The Roles and Potentials of Civil Societies

Unit Structure

1.1. Introduction
1.2. Learning Outcomes
1.3. Meaning of Civil Society
1.4. Importance of Civil Society
1.6. Summary
1.7. References/Further Readings/Web Resources
1.8 Possible Answers to Self-Assessment Exercise(s) within the content

1.1. Introduction

People across the globe are re-discovering, and attaching more importance to civil society. This realm includes NGOs but extends well beyond them to encompass people's organizations, trade unions, human rights bodies, religious groups, community-based organizations, policy activist bodies, associations of business and professional people's organizations and so forth. All may be found in the domain termed civil space called Civil Society Organizations (CSOs). We discuss in this unit the meaning of civil society; its importance for the operation of state and market; its propensity for positive feedback (virtuous circles); its role in resistance to corruption, upholding the law, safeguarding human rights, and shaping law and policy to meet human needs; and means for giving scope for positive achievements.

1.2 Learning Outcomes

By the end of this unit, you will be able to:

- Explain the meaning of civil society
- Enumerate the importance of civil societies in a country

1.3 Meaning of Civil Society

The concept of civil society is understood differently across different historical periods and depending upon ideological viewpoints and socio-cultural contexts. The African Development Bank argues that civil society is the voluntary expression of the interests and aspirations of citizens organised and united by common interests, goals, values or traditions and mobilised into collective action either as beneficiaries or stakeholders of the development process (AfDB, 2012). Though civil society stands apart from state and market forces, it is not necessarily in basic contradiction to them, and it ultimately influences and is influenced by both.

"Civil Society" is the collective noun, while "civic groups" are the individual organizations that constitute the sector. Civic organizations in civil society include non-governmental organizations (NGOs), people's and professional organizations, trade unions, cooperatives, consumer and human rights groups, women's associations, youth clubs, neighbourhood or community-based coalitions, religious groups, academic institutions and organizations of indigenous peoples (AfDB, 2001).

The original (though not particularly approving) use of the term by the Italian Marxist Gramsci in the early twentieth century, refers, not only to organizations but also to values, ethics, and conventions tending to maintain the workings of the society, which today we may interpret as those that entail trust and trustworthiness; responsibility for others; and tolerance and encouragement of ideas, creative activity, and innovations. In this unit, we use the term active humanity for the human propensities that form the basis for civil society.

Civil society in Africa is often based on religious or ethnic connections and includes traditional and spiritual forms of social organisations and networks of indigenous institutions (O'Driscoll, 2018 as cited in Cooper, 2018). Consequently, 'official' civil society in Africa is occupied by Western-type NGOs, certain churches and professional organisations and while more traditional forms of African civil society are ignored.

Self-Assessment Exercises 1

1. Define the term civil society
2. List three types of civil groups recognized in Africa

1.4. Importance of Civil Society in a country

The three modes of coordination on which modern communities depend are the market, state and civil society, of which civil society is the oldest. Before there was anything that could count as a market or as a government, human societies depended, probably for their members' survival, on practices and customs drawing on trust and mutual responsibility and individual and small-group creativity. However, without markets or government, functioning societies had to be small in scale, with only limited material exchange – and with the possibility of destructive conflict between them.

In the large integrated communities of the modern world, all three of these elements are necessary, and each of them depends to a degree for its beneficent and efficient practice on the effective operation of the other two. The market depends on the government to protect property, define and enforce the commercial rules, and settle disputes consistently; thereby increasing the predictability of the business environment, and it depends on civil society to maintain a culture of trustworthiness and qualified trust. In the absence of either of these elements, transaction costs are considerably increased, with the effect of making many desirable economic arrangements impossible. Governments, on the other hand, that have tried to dispense altogether with markets be almost universally oppressive. Governments are also immensely helped in their enforcement of laws and the equitable raising of revenue if civil society has directed a sense of responsibility into respect for the law. Active civil society, with a free and lively press and open public discussion, also contributes to the recognition of people's needs and the formulation of efficient ways of dealing with them. Civil society in turn may rely, when matters are well arranged, on being sheltered by the government through the independence and accessibility of the courts, the openness of official records and processes, and the liberties and immunities given to campaigning for parties and issues, to dissent, and ‘whistle-blowing’.

Civil-society organizations are regarded based upon three human propensities; trust and trustworthiness, responsibility, and creation. The institutionalization of each of these attributes is of routine importance in the operation of large-scale modern, as it is of small-scale primitive, societies.

First, conventional and accepted signals of trustworthiness and the resulting trust greatly reduce what would otherwise be the transaction costs of commercial buying and selling, lending and borrowing, employing and investing. As a result one party in a transaction often needs to know not the actual record of trustworthiness on the part of the other party, but only the general conditions under which trustworthiness can be presumed. The existence of commercial law and its enforcement strengthen these presumptions, but the law would provide rather feeble assurance unless it could be assumed that, in more or less recognizable circumstances, habits of honesty prevailed notably among the police and judges.

Second, it is widely recognized that raising government revenue, especially through direct taxation, would be, and is, difficult except where there is some habitual sense of responsibility, on the part of many of those eligible, to pay the amounts prescribed by law. Similarly policing to maintain civil order and to prevent oppression and predation of one person by another is very difficult in any area unless there is among the public a widespread willingness, based upon ideas of what is right, to co-operate in the process or at least not to obstruct it. Effective policing cannot rely on fear alone – unless it lapses into an undesirable degree of violence. Moreover, keeping the government honest depends on a measure of responsible self-motivated activity of scrutiny and criticism.

Third, enterprise development and enhancement of public services are unlikely to proceed far unless they draw on the propensity of workers in both sectors for creation. Without a habit of innovation and improvement routinely drawn upon and given its head, these activities would presumably have to be coaxed out by material rewards or else forgone.

The saving property of these habits of mind and behaviour so usefully institutionalized by civil society is that their status as propensities implies a capacity of our species to enjoy their exercise. Once we have experienced a culture of trustworthiness and trust, of responsibility for other people, or creation, we easily come to enjoy it, a fact that probably has something to do with the need of our hunting-gathering ancestors for these qualities for their societies, and consequently for their genes, to survive. So the institutionalized habits are to a degree self-reinforcing.

The increasing emphasis in democracies since the 1990s on the need for public consultation over government measures seems to be a recognition of these possibilities. As an example of this even in an international context, the Cotonou Treaty between the European Union and its African, Caribbean and Pacific Associates specifically requires consultation with the people affected over measures to be taken under it.

Self-Assessment Exercises 2

1. Define the term civil group.
2. Identify the three modes of coordination on which modern communities depend
3. Civil society organizations depend on three human propensities, list them

1.5. Summary

In this unit, we discussed the roles and importance of civil society. In summary, civil society is a space whose function is to mediate between the individual and the state. While there may not be a clear-cut definition of civil society, they more or less agree that it comprises institutions such as religious organizations, labour unions, charities, community groups, nonprofits, and the media. In advanced and virile democratic systems these institutions supplement formal processes such as voting and help citizens shape the culture, politics, and economies of their nation. Civil-society organizations are based upon trust, trustworthiness and responsibility.

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1.7 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). The African Development Bank defined civil society as the voluntary expression of the interests and aspirations of citizens organized and united by common interests, goals, values or traditions and mobilized into collective action either as beneficiaries or stakeholders of the development process.

2). Official civil society in Africa includes non-governmental organizations (NGOs), professional organizations, trade unions, cooperatives, consumer and human rights groups, women's associations, youth clubs, neighbourhood or community-based coalitions, religious groups, academic institutions and organizations of indigenous peoples.

Answers to SAEs 2

1). Civic groups are the individual organizations that constitute civil societies.

2). The three modes of coordination on which modern communities depend are the market, state and civil society. Before we have a market or a government, human societies depended probably on their members' survival, on practices and customs drawing on trust and mutual responsibility and individual and small-group creativity. The market depends on the government to protect property, define and enforce the commercial rules, and settle disputes consistently; thereby increasing the predictability of the business environment. The market also depends on civil society to maintain a culture of trustworthiness and qualified trust. In the absence of either of these elements, transaction costs are considerably increased, with the effect of making many desirable economic arrangements impossible. Governments are also immensely helped in their enforcement of laws and the equitable raising of revenue if civil society has directed a sense of responsibility into respect for the law.

3). Civil-society organizations as based upon three human propensities; trust and trustworthiness, responsibility, and creation.

UNIT 2 POSITIVE FEEDBACK MECHANISMS OF CIVIL SOCIETY

Unit Structure

2.1. Introduction

2.2. Learning Outcomes

2.3. The Role of Civil Society in Upholding the Rule of Law

2.4. Giving Scope to Active Humanity in Social and Commercial Ventures.

2.5. Summary

2.6. References/Further Readings/Web Resources

2.7. Possible Answers to Self-Assessment Exercises within the content

2.1 Introduction

The positive feedback mechanisms in these civil-society institutions appear sometimes to go beyond common expectations if we can judge by the four striking cases presented in this module. Not only does the prevalence of trustworthiness in certain circles and situations promote the habit of trust, and the manifest collective advantages of law observance once experienced tend (provided the laws are not perversely counterproductive) to make it socially-expected habit. It also seems from the examples that voluntary co-operation and mutual responsibility developed for one immediate purpose may lead to their mobilization for other desirable causes with which the original goal has no very obvious connection, such as support for gender equality and active opposition to official corruption and inter-ethnic violence. Perhaps more obviously to be expected, the social improvement achieved through voluntary cooperation on one project arouses hope that voluntary cooperation will be possible on other projects, and these hopes may be realized.

2.2 Learning Outcomes

By the end of this unit, you will be able to:

- Illustrate the role of civil society in upholding the rule of law
- Describe the scope of active humanity in social and commercial ventures.

2.3. The Role of Civil Society in Upholding the Rule of Law

We have described civil society as an important organization with the role of maintaining some key elements of good governance. This involves a readiness to use whatever freedoms and opportunities are provided by the government to identify and combat abuses. Freedom of the media and expression and electoral democracy is of course extremely important here, but it is civil society in both its senses that largely determines how far the opportunities provided by the political system will be used. Even where these freedoms do not exist, people of courage, sometimes with international support, may find ways to oppose abuses effectively.

There are two main functions required here; exposure and correction. Exposure involves investigation and publicity either of abuses or citizens' legal rights or of opportunities in practice for vindicating those rights. The publicity may take place through the press or other regular communication media or ad hoc publications, street drama, and public meetings, as occasion permits. Academic institutions or charitable foundations or campaigning bodies may finance or otherwise further the investigation, and it may sometimes be necessary also for civil-society organizations to take action through lobbying and campaigning directed at the executive, through the law, through financial support, or through further exposure to protect those who investigate and publicize.

Correction within the law and the requirements of public order may involve demonstrations, personal lobbying, letters or petitions to those in power, action through the courts, or the use of electoral politics. Due to the varied temptations for those in power to misuse their power for private purposes, override the law, or infringe human rights, it seems likely that even the 'cleanest' political system will need a readiness from outside government for active exposure and correction.

Sen (1995) stresses the importance of political freedoms for informing governments about what is going on and about the needs that people feel and for generating the open discussion that can lead to the formulation of remedies. Again the readiness to use these channels and the organization to do so effectively is a function of civil society. Beyond the support for honest government and the rule of law and defence of civil rights, the expression to those in the power of needs, and the thrashing out of ideas on how they may be met, we suggest through the cases that follow that the mobilization of what we have called above 'active humanity', on which civil society rests, has further large potential for improving and supplementing the working of governments and markets in their enhancement of human welfare.

Self-Assessment Exercise 1

1. How does civil society uphold the rule of law?

2.4 Giving Scope to 'Active Humanity' in Social and Commercial Ventures

The four 'cases' presented in this unit reproduce accounts of how innovative mechanisms drawing on active humanity have produced remarkable results in commercial and social projects of significant scale. Of the four examples, three come from developing countries, though in one case from a relatively rich area of a country later just making it into upper middle income. The fourth comes from what was initially a highly disadvantaged area (characterized by having a high proportion of recent immigrants from developing countries) in an affluent country. One of the establishments concerned is a major infrastructure project in a squatter settlement within one of the world's mega-cities; one is a government-established irrigation settlement; one is a commercial manufacturing enterprise, and one is a network of community facilities in a highly deprived part of a rich-world conurbation.

In commercial enterprises a device exemplified here, Case 3, is to devolve an extraordinary degree of responsibility to small, face-to-face groups of workers, ensuring that they are provided at the same time with the incentives to pursue the objectives of the larger organization. The somewhat analogous device of 'solidarity groups' of very poor borrowers plays a key part in the Grameen model of micro-credit. For public utilities, existing or projected, an approach adopted is to motivate those benefiting from, or subsisting on, a project to play a direct, voluntary part in constructing, maintaining, and managing it. This may, as in Case 2 below, replicate practices followed often in the past by purely non-state local activity for environmental conservation through the regulation of access to some natural resource; in such cases, the informal systems of management have sometimes persisted for centuries. Or it may, as in Case 1, work through undertaking a large infrastructure project-technically innovative perhaps but entirely modern – of a kind normally now constructed and managed by the government, either directly or through a contract with one or more commercial entities.

Alternatively, a big local non-government network of social projects may be built from scratch by starting with work by a small group of volunteers to provide a facility generally recognized as urgently needed, Case 4. All those described have drawn on propensities for responsibility, mutual trust, and creativity, and all depended at first on one person or a very small group of people to generate the idea and to begin the process of motivation.

Self-Assessment Exercise 2

1. Discuss the step to take in giving scope to social and commercial ventures.

2.5. Summary

In this unit, we discussed the role of civil society in helping societies to resist corruption and uphold the rule of law. We also discussed the four 'cases' that reproduce accounts of how innovative mechanisms drawing on active humanity have produced remarkable results in commercial and social projects of significant scale.

2.6 References/Further Readings/Web Resources

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2.7 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). Civil society can uphold the rule of law in two using exposure and correction.

(i). Exposure involves investigation and publishing of any abuses of citizens' legal rights or of opportunities in practice for vindicating those rights. The publicity may take place through the press or other regular communication media or ad hoc publications, street drama, and public meetings, as occasion permits. Academic institutions or charitable foundations or campaigning bodies may finance or otherwise further the investigation, and it may sometimes be necessary also for civil-society organizations to take action through lobbying and campaigning directed at the executive, through the law, through financial support, or through further exposure to protect those who investigate and publicize.

(ii). The second is a correction within the law and the requirements of public order which may involve demonstrations, personal lobbying, letters or petitions to those in power, action through the courts, or the use of electoral politics. Due to the varied temptations for those in power to misuse their power for private purposes, override the law, or infringe human rights, it seems likely that even the 'cleanest' political system will need a readiness from outside government for active exposure and correction.

UNIT 3 CHANGE IN BEHAVIOUR: GENERALIZATIONS FROM THE FOUR CASES

Unit Structure

3.1. Introduction

3.2. Learning Outcomes

3.3. Impetus Among the workforce, farmers and the community

3.4. The key to being turned in each case of change in behaviour

3.5. Summary

3.6. References/Further Readings/Web Resources

3.7. Possible Answers to Self-Assessment Exercises (SAEs) within the content

3.1 Introduction

According to Uphoff (1996), three elements are crucial in the Gal Oya experience of change behaviour: ideas, ideals, and friendship. The ideals and the value-free ideas are frequently bound up together. This unit discusses the impetus among the workforce, the farmers and the community as a whole. We will also discuss the basic keys to be turned in in each case of change behaviour.

3.2 Learning Outcomes

By the end of this unit, you will be able to:

- Explain the impetus among the workforce, farmers and the community
- Describe the basic key to be turned in each case of change behaviour.

3.3 Impetus among Workforce, Farmers and the Community

According to Uphoff (1996), three elements are crucial in the Gal Oya experience of change behaviour: ideas, ideals, and friendship. Ideas and ideals may be potently expressed in pithy sayings. Ideas, if we understand him correctly, maybe more-or-less value-free: about what leads to what or how some end may be attained. Ideals are particular type of idea that expresses a commitment to values. Yet, in practice, the ideals and the value-free ideas are frequently bound up together. The Gal Oya farmers' slogan 'Water has no colour' (where 'colour' refers to political party allegiance) can be read to mean either that it is possible or most efficient to deal with water without bringing in politics, or that water is a gift to all and should not be appropriated for factional ends- or of course both. Pragmatic ideas shade into ideals. 'We find moral and practical considerations reinforcing each other'.

The weight given to friendship explains itself given that so much depended on the tapping of people's capacity for altruism. Once farmers started valuing others' well-being in addition to their own, many new possibilities opened up. People's subjective willingness to contribute to each other's improvement produced measurable, objective consequences in terms of higher water use efficiency and larger harvests.

In Semco and Balsall Heath, too, we can see a tendency for change to start with ideas of a fairly pragmatic kind but then to move on to ideals, and maybe also for friendships to be formed as events proceed and to help sustain what progress has been made. It is possible to see the reforms that Ricardo Sernler began to introduce from about 1984 as pragmatic – unusual only in that he was especially sensitive to what was wrong and exceptionally imaginative and daring in the search for remedies. Eventually, however, the reforms do seem to have come to express a fairly clear set of human values. Similarly, the St Paul's project at Balsall Heath started with a nursery centre where children of working parents and others could be left, if necessary right through the working day, and have among other things the benefit of pre-school: an urgently needed service. The community education and resource centre, the school, the newspaper, the enterprises, the drama, resistance to crime, and all the rest followed, eventually expressing a strong community ideal, and, in Atkinson's words, 'achievement, quality, standards, hard work, neighbourliness and faith'.

All the experiences discussed in the introduction depended on the emergence of a strong impetus from within, among the workforce, the farmers and the resident community, although, it was often outsiders or incomers who set the fuse or pulled the trigger. Sometimes it is easier for outsiders than for insiders to believe that change is possible and to convince others. The starting move may be very simple. Neighbours who have similar interests but would not normally meet are led to come together. People geared to regard each other as opponents or indifferent are brought into conversations. Someone behaves in a generous or accepting or respectful manner contrary to the stereotype. A positive achievement breaks the cycle of despair. Some unexpected act or event opens up a new set of possibilities.

3.1.1. Character of the Raw Material

These stories, to which many analogues could no doubt be given from the experience of some of the 'development' NGOs, remind us of the remarkable character of the human raw material. Remember that there had to be regarded as especially unpromising cases for the kind of experiment that was mounted: certainly Gal Oya and Balsall Heath, and, given the labour-relations scene in Brazil and the economic turbulence of the period, probably also Semco. The results suggest that we carry within ourselves, as Uphoff argues, the capacity for generosity and co-operation; the capacity, we might add, for creation. It may need only a set of initial stimuli, the right personal move that will start the process, to bring these characteristics into play. The neighbourhood, the school, the farming settlement, and the firm, that can tap into these capacities is on to a good thing.

Self-Assessment Exercises 1

1. List the three elements that are crucial in the Gal Oya experience.
2. Discuss the contributions of the workforce to change in behaviour in a workplace

3.4. The Key to being Turned in Each Case of Change Behaviour

In each of the stories, we may see some ingredient as a kind of key that has to be turned to set the process going. In Gal Oya, the key was perhaps generosity. Whatever exactly set the process going in the first place, change became rapid as soon as this element was released. Once there was a framework in which it was clear that generosity need not be wasted, that contributions to the well-being of others formed part of a wider venture with large potential effects, farmers became cooperative, and indeed generous, often beyond the apparent call of duty. From what is recorded we can speculate that the respect for farmers shown by the institutional organizers, and indeed their generosity with time and attention, boosted these tendencies, and possibly formed the original stimulus. Uphoff also believes that the action of six (Sinhalese) farmer-representatives in protecting the houses of two minor (Tamil) irrigation officials, when some of the houses of Tamils in the district town had been burned by a mob, may have helped to generate a more respectful attitude to farmers on the part of irrigation officials generally, most of whom were Tamils. Also, the constructive activity and effort of farmers made it hard for the demeaning stereotypes of them previously held by officials to persist.

In Semco, the key was autonomy: autonomy for business units, manufacturing cells within them, and individuals at large – the autonomy of course always limited by the need to keep people and units working together, but this need is fulfilled through personal ties of responsibility, and through common sense in response to knowledge and personal appropriation of the purpose of the exercise, rather than through rules and commands. Autonomy for the very small units meant that it was easy for individuals to command respect and to play a creative role within them.

In Balsall Heath, perhaps, the key was confidence. The project, by bringing people together in visible achievements, showed that there were responses other than helplessness, apathy and destruction. Creation was a possibility requiring people to act together with some sense of purpose, and the achievement that generated further confidence would follow. The purpose in turn depended on a certain measure of faith and hope, a vision. Though the mechanics are not spelt out, it seems that the act of providing the nursery with both showed the possibility of community action and brought people together. From this combination, a positive creative purpose could be born.

However, active humanity came to the forefront: mutual trust, responsibility, and creation. Life became so much less nasty and brutish, not because a superior coercive power was introduced - in fact, in one way or another, that was precisely what was abandoned - but because the propensities of people to work together, to take care of each other, and to exercise their ingenuity and imagination - all potentially enjoyable experiences - were brought into play.

3.2.1 Common Factors or Preconditions

Among the common factors (which may have been preconditioned) in all the experiences discuss so far were: communication – it was necessary for people to talk to each other when they might not normally have done so; respect – the essential actors had to be treated as responsible human beings if they were to behave as such; and vision, involving a form of risk-taking – some leaps of faith had to be made, relying on ‘the evidence of things not seen.

Self-Assessment Exercises 2

1. List the keys to be turned to achieve a change in behaviour in the workplace.
2. Explain the keys listed in question 1.
3. Briefly explain why the Gal Oya experience led some Sinhalese farmers to defend Tamil irrigation officials from racist attacks

3.5. Summary

In this unit, we discussed the impetus among the workforce, farmers and the community and the key to be turned in in each case of change behaviour. Behaviour change is a research-based consultative process for addressing knowledge, attitudes and practices. It provides relevant information and motivation through well-defined strategies, using a mix of media channels and participatory methods. Behaviour change strategies focus on the individual as a locus of change. Among the common factors identified in all the experiences to be turned in in each case of change, behaviour is communication, respect and vision.

3.6 References/Further Readings/Web Resources

Bell, H. O. & Dean, E. U. (2014). *Introduction to Development Economics, Corruption and Poverty, 2nd Edition.* West Point Publication Company.

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Wayne Nafziger (2006). *Economic Development, 4th Edition.* UK: Cambridge University Press.

3.7 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). According to Uphoff (1996) the three elements that are crucial in the Gal Oya experience of change behaviour are (i) Ideas, (ii) Ideals, and (iii) Friendship.

2). The contributions of the workforce to change in behaviour in a workplace can be attributed to the three elements which are crucial in the Gal Oya experience of change behaviour namely ideas, ideals, and friendship. Ideas, maybe more-or-less value-free, that is, about what leads to what or how some end may be attained. Ideals are particular type of idea that expresses a commitment to values. Yet, in practice, the ideals and the value-free ideas are frequently bound up together. Pragmatic ideas shade into ideals. Moral and practical considerations reinforce each other. The weight given to friendship explains itself given that so much depended on the tapping of people's capacity for altruism. In Semco and Balsall Heath, too, we can see a tendency for change to start with ideas of a fairly pragmatic kind but then to move on to ideals, and maybe also for friendships to be formed as events proceed and to help sustain what progress has been made.

3). The action of six (Sinhalese) farmer-representatives in protecting the houses of two minor (Tamil) irrigation officials, when some of the houses of Tamils in the district town had been burned by a mob, may have helped to generate a more respectful attitude toward farmers on the part of irrigation officials generally, most of whom were Tamils. Also, the constructive activity and effort of farmers made it hard for the demeaning stereotypes of them previously held by officials to persist.

Answers to SAEs 2

1). The keys are Confidence, autonomy and generosity

2). (i). Confidence: One of the keys in Balsall Heath was confidence. The project, by bringing people together in visible achievements, showed that there were responses other than helplessness, apathy and destruction. Creation was a possibility requiring people to act together with some sense of purpose, and the achievement that generated further confidence would follow depending on a certain measure of faith and hope, a vision. From this combination, a positive creative purpose could be born.

(ii). Autonomy: In Semco, the key was autonomy for business units, manufacturing cells within them, and individuals at large. Autonomy of course always limited by the need to keep people and units working together, but this need is fulfilled through personal ties of responsibility, and through common sense in response to knowledge and personal appropriation of the purpose of the exercise, rather than through rules and commands. Autonomy for the very small units meant that it was easy for individuals to command respect and to play a creative role within them.

(iii). Generosity: In Gal Oya, the key was perhaps generosity. Whatever exactly set the process going in the first place, change became rapid as soon as this element was released. Once there was a framework in which it was clear that generosity need not be wasted, that contributions to the well-being of others formed part of a wider venture with large potential effects, farmers became cooperative, and indeed generous, often beyond the apparent call of duty.

Module 3: Globalization and Development

People have been migrating and trading throughout human history and these have created interactive networks that connect the different parts of the world and produce dependent economic relationships. In this module, we discuss this global interaction, the history of globalization, international trade and international financial flows. The specific unit topics are

Unit 1: Concept of Globalization
Unit 2: The New Globalization
Unit 3: International Trade
Unit 4: International Financial Flows

Unit 1 Concept of Globalization

Unit Structure

1.1. Introduction
1.2. Learning Outcomes
1.3. Conceptualization of the term Globalization
1.4. History of Globalization
1.5. International Trade and International Financial Flows
1.6. Globalization of the International Labour market
1.7. Summary
1.8. References/Further Readings/Web Resources
1.9. Possible Answers to Self-Assessment Exercises (SAEs) within the content

1.1 Introduction

Readers whose familiarity with the literature in the fields of economics and business is confined to materials published from 1995 onwards will know that one of the most common words to be found in the titles of books and articles since that year is 'globalization'. They may be surprised to learn that, before 1970, there is no record whatsoever of the use of 'globalization' in a title. Given the wide range of issues debated under the 'globalization' heading, it is necessary to define, and so delimit, the 'economic globalization' discussed in this chapter in such a way as to ensure that our primary focus on economic development is maintained.

1.2 Learning Outcomes

By the end of this unit, you will be able to:

- Define and explain the meaning of globalization
- Trace the history of globalization
- Describe the fundamentals of globalization.

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3.1 Conceptualization of the Term Globalization

What do you understand by globalization? The term globalization comes from English, which refers to the emergence of an international network, belonging to an economic and social system. One of the earliest uses of the term "globalization" was in 1930 - in a publication entitled, Towards New Education, which was designated as an overview of the human experience in education. Globalization is used to describe the growing interdependence of the world's economies, cultures, and populations, brought about by cross-border trade in goods and services, technology, and flows of investment, people, and information (Peterson Institute for International Economics, 2021). Countries have built economic partnerships to facilitate these movements over many centuries. Globalization involves economic integration; the transfer of policies across borders; the transmission of knowledge; cultural stability; the reproduction, relations, and discourses of power; it is a global process, a concept, a revolution, and “an establishment of the global market free from sociopolitical control.

Globalization carries multiple meanings, nuances, and applications. These include:

- **The formation of a global village** through closer contact between different parts of the world, with increasing possibilities of personal exchange, mutual understanding, and friendship between world citizens and the creation of a global civilization. The World Bank defines globalization as the freedom and ability of individuals and firms to initiate voluntary economic transactions with residents of other countries. Marshall McLuhan’s idea of the global village was introduced in his book Explorations in Communication (1960). The United Nations has coined the term Our Global Neighborhood to describe an emerging world political context.
- **Globalization theory** aims to understand complex connectivity proliferating at the global level considering both its sources and its implications across the various spheres of social existence.
- **In political science and international relations,** the current unit of analysis is the nation-state. Globalization has brought forth supranational organizations and international regimes, that is, commonly accepted laws and commonly accepted practices. The loss of sovereignty by the nation-state to transnational and supranational organizations is of greatest concern. A world-system perspective is a world with a common political system (with a common social and cultural system), linked by a common language, cultural practices, and institutions.

- **In sociology and communications,** globalization is understood as a global mass culture dominated by modern means of cultural production (movies, television, the Internet, mass advertising, and so on). Mass communication produces images that cross and re-cross linguistic frontiers more rapidly and easily than goods and services and immediately speak across languages. Global mass culture is dominated by how the visual and graphic arts have entered directly into the reconstitution of popular life, entertainment, and leisure with the image, imagery, and styles of mass advertising. This is dominated by Western cultural values and techniques. This process is homogenizing but also enormously absorptive of techniques and practices.
- **Economic globalization** refers to free trade and increasing relations among members of an industry in different parts of the world (globalization of an industry), with a corresponding erosion of national sovereignty in the economic sphere. The IMF defines globalization as the growing economic interdependence of countries worldwide through increasing volume and variety of cross-border transactions in goods and services, freer international capital flows, and more rapid and widespread diffusion of technology (IMF, World Economic Outlook, May 1997).

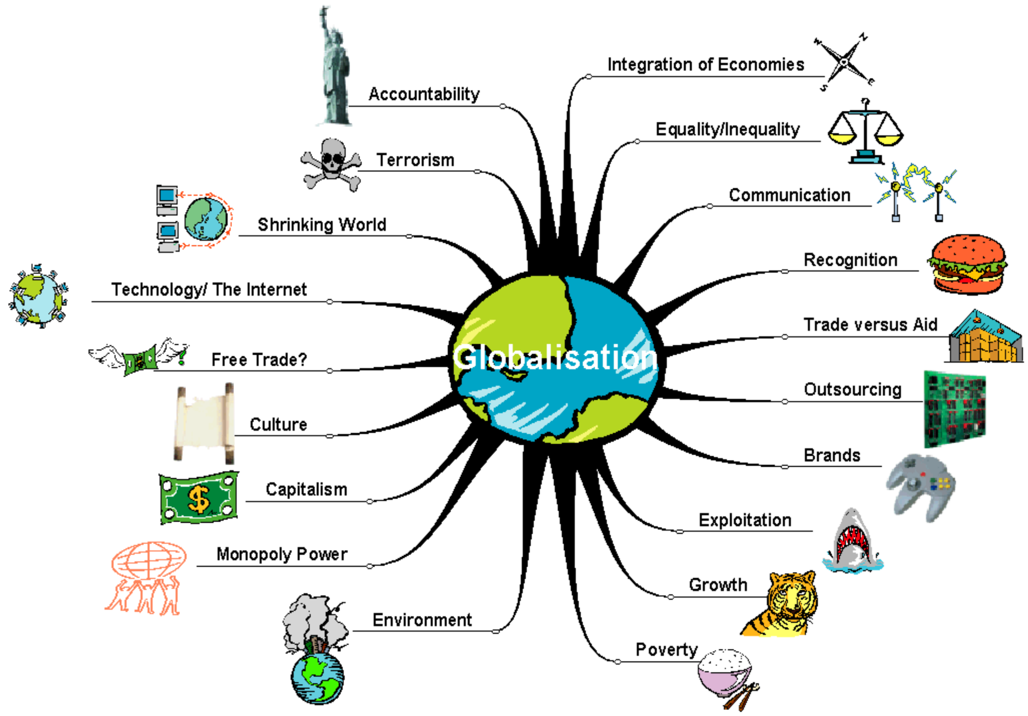

Figure 3: Globalisation map
Source: Tanasescu, Dumitru, & Dinca, (2012)

Globalization can be linked to the local, the national and the regional. On the one hand, a connection is made between social and economic relationships and networks, organized on a local and/or national, on the other hand, it connects social and economic relationships and networks crystallized on a wider scale the regional and global interactions. In 2000 the International Monetary Fund identified four basic aspects of globalization: trade and transactions, capital movements and investment, migration and movement of people and the spreading of knowledge (IMF, 2000).

Self-Assessment Exercises 1

1. Discuss the term globalization
2. The International Monetary Fund identified four basic aspects of globalization, what are they?
3. What is economic globalization?

1.4 History of Globalization

The origin of globalization is viewed differently, because some authors have argued that globalization originated in the 1490s, by referring to the origins of civilization when groups of people first came into contact with one another through trade and migration. It has also been argued that globalization became significant in the 16th century during the beginnings of colonialism. According to this view worldwide flows of trade, labour and capital are connected places, and integrated into the global economy (Grant & Short, 2002). Some authors argue that the globalization bang took place in the 1820s, by referring to transport cost declines and trade between countries of the world (O'Rourke & Williamson, 2002), while others assert that globalization ran its course from the middle of the 19th century to the outbreak of the First World War, by referring to technical innovations such as telegraphs, telephones, railways and steamships, as well as the adoption of free trade policies by major trading countries of the world. However, the First World War of 1914-18 is argued to have interrupted and for a time set into reverse the process of globalization, since the war changed the economic structure of the combatants' economies (Broadberry & Harrison, 2005).

During the 1870s several countries embraced gold monometallism resulting in the era of the Classical Gold Standard in the United States. The Gold Standard served as a standard of value and a medium of exchange as well as the maintenance of a fixed price of national money in terms of gold and this lasted till about the First World War. The period preceding the 1920s is believed to have been stable and prosperous. For example, during the Classical Gold Standard Era and specifically, between 1870 and 1913 there was a rapid expansion in international trade and countries such as Europe and the United States had a share of trade in openness that increased gradually and reached a peak in 1913. Between 1920 and 1929 many countries attempted to maintain domestic income in the face of shrinking markets through devaluation of their respective currencies, declining production and business activities. These countries resorted to exchange and trade restrictions, which in turn led their trading partners to adopt the same policies, leading to a destructive vicious cycle. During the period 1920-29, there was increasing global economic instability, which was associated with welfare losses and the world economy experienced a contraction, which came to be known as the Great Depression which lasted for 4 years (1929-1933). During the Great Depression, money supply, output and prices all fell. But, the collapse of output and prices and the loss of savings, as banks closed during the early 1930s were exactly what the Gold Standard had promised to prevent since it ensured economic stability in the countries that adhered to the operations of this system.

After the Second World War of 1939-44, three international institutions were, as a result, created to manage the global economy. These institutions included the IMF, the IBRD, now called the World Bank, and the GATT, now called the WTO. The World Bank in the form of the IBRD and the IMF was established at an international conference at Bretton Woods, New Hampshire in 1944. The GATT was created as part of the 1946 negotiations in London also at the initiative of the United States on establishing an international institution for trade, in order, to complete the existing structure of the Bretton Woods economic institutions. These negotiations on the ITO were further continued in Geneva in 1947, where they were successfully conducted and resulted in the initiation of GATT. But, in 1990 the first proposals for the initiation of a new international trade organization were tabled by Canada and the European Community, about improving the institutional mechanisms of the GATT and its dispute settlement system. In April 1994 the agreement establishing the WTO was signed in Marrakesh, Morocco and the WTO replaced GATT (UNCTAD, 2003).

Self-Assessment Exercises 2

1. The agreement establishing the WTO was signed in what year
2. List the three international institutions that were created to manage the global economy after the Second World War

1.5 International Trade and International Financial Flow

Economic globalization processes are also important to both international trading of goods and services as well as to international financial flows.

1.5.1 International Trade

The most salient form of globalization is the continued expansion of international trade in goods and non-financial services. (Trade in financial services is discussed later in this section.) There have always been countries whose levels of economic activity were heavily dependent on trading performance – though, for most nations, this has not been the case, and the level of trade dependence has been relatively low. There is, however, a fundamental difference between the trading structures being created today and those of earlier eras. The outward orientation of economies, including developing economies, is now seen as crucial to sustained growth. Thus, for instance, the important partnership agreement between the EU and the African, Caribbean and Pacific (ACP) states embodied in the Cotonou Agreement sees the integration of the ACP countries into the world economy as the key element in the development package provided by the Agreement for its 77 developing-country signatories – over half of the world's developing nations (The ACP-EU Courier, 2000). The vision of world trade implied by this ambition is one in which trading is no longer a peripheral aspect of a nation's economic activity, but central to it – the engine of growth. This greatly increased emphasis on international specialization and interdependence of nations is a key feature of the true globalization of trade and is regarded as the main reason for the accelerated economic growth that it is expected to bring with it.

1.5.2 International Financial Flows

Economic globalization processes are also important to international financial flows. Modern financial integration began in the early 1970s following the collapse of the Bretton Woods system which had, in effect, tied other currencies to the US dollar. With the move to flexible, in some cases floating, exchange rates, the importance attached to controls on foreign-exchange transactions was greatly diminished. In particular, the regulation of international movements of capital was progressively wound down so permitting moves towards a unified, global market in the capital.

Deregulation of financial markets in the US, Europe and Japan in the 1980s and 1990s, coupled with broadly favourable global business conditions in the shape of low-interest rates and rapidly rising share prices, encouraged massive increases in demand for international banking services by corporations and governments and opened up many opportunities for banks and other financial institutions wishing to develop and market new financial products across national boundaries. Governments made increasing use of international financial institutions for, amongst other things, issuing government debt in the form of internationally marketed bonds, investing reserves, and managing privatizations. Multinational corporations became major purchasers of the international expertise and services of international financial institutions – to assist in raising investment capital, facilitate foreign direct investment (FDI) abroad, oversee mergers and acquisitions, and provide regular banking services.

Banks, corporations and financial institutions raised capital across the globe by borrowing, and by selling equity. The increased opportunities thus created for banks and other financial institutions to supply an ever-broadening array of financial services have led to intensified competition amongst providers. The shortage of genuine expertise in this booming market, and the difficulty many firms experienced in providing, on their own, adequate, broadly based services, have encouraged mergers and takeovers in the financial-services sector itself (as firms search for, and find, suitably qualified partners).

This process of international expansion of banking operations, portfolio-investment markets, and other financial markets, has been enormously encouraged by the rapid improvement in both international communications and data processing (changes discussed in greater detail in the next section) which make possible the tight integration of widely dispersed transactions previously conducted on a more limited and especially fragmented way in individual national or regional markets.

At the level of the firm, the continued increase in the importance of FDI flows to developing (and developed) countries as a source of investment finance has been paralleled by the building by multinational corporations (MNCs) of worldwide networks of interconnected affiliates and subsidiaries - across which output and earnings (representing, in total, a significant proportion of the world's production and exports) are distributed according to globally optimized plans.

Self-Assessment Exercises 3

1. Highlight how the expansion of international trade in goods and non-financial services is a form of globalization.
2. Describe how international financial flows occur in an economy.

1.6 Globalization of the International Labour Market

A further manifestation of globalization is the gradual emergence of an integrated international labour market. The global labour market is still fragmented and highly regulated but, the international movement of workers is becoming increasingly important both to host countries, which require the services provided by incoming labour, and to source countries, which in many cases derive considerable benefit from the flow of remittances from their citizens working abroad. Over the past two decades, labour markets around the world have become increasingly integrated. Political changes and economic reforms have transformed China, India, and the former Eastern bloc countries, effectively involving their large labour forces in open market economies. At the same time, the development of technology, combined with the progressive removal of restrictions on cross-border trade and capital flows, has made it possible for production processes to be unbundled and located farther from target markets for a growing universe of goods and services. The location of production has become much more responsive to relative labour costs across countries. There have also been increasing flows of migrants across borders, through both legal and informal routes.

1.6.1 Globalization of information and ideas

Running in parallel with the changes mentioned above has been a very rapid broadening of the range of information, ideas and comment available quickly and cheaply, to economic agents and the general public alike, on all manner of topics. The use of the Internet, in particular, has tied together with a worldwide network of information providers and seekers, greatly facilitating the free flow of knowledge and ideas from the highly technical, through the news of current happenings in all parts of the world, to the polemical.

Self-Assessment Exercises 4

1. Write short note on international labour market.
2. Explain how information and ideas are part of globalization

1.7 Summary

In this unit, we discussed the meaning and history of globalization. Globalization is the process of international integration arising from the interchange of world views, products, ideas, and other aspects of culture. We note that the combination of technological advances and political support that sustains the present wave of globalization has precedents, that in many ways the world economy was more extensively globalized in 1914 than it is now, and that waves of globalization can recede if political support is withdrawn. We then look in detail at the main international institutions promoting global integration – their history and current aims. A synoptic account of the evolution of trade policy since the 1950s follows, closing with a summary of the difficulties encountered by the WTO in attempting to pilot the Doha Round negotiations to a successful conclusion in 2008. We then turn to examine the anticipated impact on developing countries - the theoretically predicted costs and benefits – of liberalizing international trade. Financial globalization is examined in the same way as trade liberalization, with special attention being paid to the so-called collateral benefits that may result from the integration process. The impact (actual and potential) of liberalizing the global labour market was assessed; followed by a brief look at key issues raised by the globalization of ideas and knowledge.

1.8 References/Further Readings/Web Resources

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1.9 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). The term globalization comes from English referring to the emergence of an international network, belonging to an economic and social system. Globalization is used to describe the growing interdependence of the world's economies, cultures, and populations, brought about by cross-border trade in goods and services, technology, and flows of investment, people, and information. Countries have built economic partnerships to facilitate these movements over many centuries. Globalization involves economic integration; the transfer of policies across borders; the transmission of knowledge; and the establishment of the global market free from sociopolitical control.

2). The International Monetary Fund identified four basic aspects of globalization (i) Trade and transactions, (ii) Capital movements and investment, (iii) Migration and movement of people and (iv) The spreading of knowledge

3). Economic globalization refers to free trade and increasing relations among members of an industry in different parts of the world, with a corresponding erosion of national sovereignty in the economic sphere. The IMF defines economic globalization as the growing economic interdependence of countries worldwide through increasing volume and variety of cross-border transactions in goods and services, freer international capital flows, and more rapid and widespread diffusion of technology

Answers to SAEs 2

1). The agreement establishing the WTO was signed in April 1994 at Marrakesh, Morocco and the WTO replaced GATT

2). The three international institutions that were created to manage the global economy after the Second World War of 1939-44 were the IMF, the IBRD, now called the World Bank, and the GATT now called the WTO.

Answers to SAEs 3

1). The most prominent form of globalization is the continued expansion of international trade in goods and non-financial services. Some countries' levels of economic activity were heavily dependent on trading performance and the level of trade dependence has been relatively low. As a result of globalization, the trading structures being created today and those of earlier eras are different. The outward orientation of economies, including developing economies, is now seen as crucial to sustained growth. The vision of world trade through globalization is one in which trading is no longer a peripheral aspect of a nation's economic activity, but central to it as an engine of growth. This greatly increased emphasis on international specialization and interdependence of nations as a key feature of the true globalization of trade and is regarded as the main reason for the accelerated economic growth that it is expected to bring with it.

2). International financial flows involve international banking services by corporations and governments. This opened up opportunities for banks and other financial institutions wishing to develop and market new financial products across national boundaries. Governments made use of international financial institutions for issuing government debt in the form of internationally marketed bonds, investing reserves, and managing privatizations. Multinational corporations assist in raising investment capital, facilitate foreign direct investment (FDI) and provide regular banking services. Banks and financial institutions also raise capital across the globe by borrowing, and by selling equity. The increased opportunities thus created for banks and other financial institutions to supply an ever-broadening array of financial services have led to intensified competition amongst providers. This process of international expansion of banking operations, portfolio-investment markets, and other financial markets, is also encouraged.

Answers to SAEs 4

1). Globalization can emerge in form of an integrated international labour market. The global labour market is highly regulated but, the international movement of workers is important both to host countries. Also, source countries may derive considerable benefit from the flow of remittances from their citizens working abroad. Over the past two decades, labour markets around the world have become increasingly integrated. For instance, political changes and economic reforms have transformed China, India, and the former Eastern bloc countries, effectively involving their large labour forces in open market economies.

2). Information and ideas are part of globalization by being available quickly and cheaply, to economic agents and the general public alike, on all manner of topics. The use of the Internet, in particular, has tied together with a worldwide network of information providers and seekers, thereby facilitating the free flow of knowledge and ideas from the highly technical, through the news of current happenings in the world.

UNIT 2 THE NEW GLOBALIZATION

Unit Structure

2.1. Introduction
2.2. Learning Outcomes
2.3. Globalization Policy
2.4. Technology and Globalization
2.5. International Organizations and Globalization
2.6. Decision-Making by the World Bank and the IMF
2.7. Summary
2.8. References/Further Readings/Web Resources
2.9. Possible Answers to Self-Assessment Exercises (SAEs) within the Content.

2.1 Introduction

What differentiates the wave of globalization which has engulfed the world since the early 1990s from earlier international integration is a combination of factors such as technological innovations; political willingness on the part of many influential countries to promote the international integration of markets by removing barriers to trade and other international economic transactions; the pro-globalization activities of a growing number of international agencies and institutions; an ever-expanding array of private-sector agents engaged in international trade and foreign investment firms, banks, and other financial and commercial organizations focused on pursuing enhanced profits by participating in the globalization process; feedback from the success of globalization itself: expansion of the global economy, and global income, which provides ever-increasing opportunities for profitable participation in the process -through involvement in trade, international finance, foreign investment, and other activities that reinforce globalization as discussed in this unit.

2.2 Learning Outcomes

By the end of this unit, you will be able to:

- Describe what is meant by globalization policy
- Describe how technology influences globalization
- Differentiate the roles of international organizations in the globalization process

2.3 Globalization Policy

It is important to recognize that a technological revolution is not a sufficient condition for globalization to take place. The technological developments referred to above, and the political will to embrace them or encourage their use, are both necessary for the pace of globalization to be stepped up radically. While the availability of the Internet and satellite-communication technology have made possible for the first time easy and cheap communication over long distances; the actual making use of the opportunities so created can be made difficult by the government. Thus, about information flows themselves, it is still possible to block, up to a point, private access to long-range Internet and telephone facilities – and where there are technical problems with so doing, some reduction in usage can be achieved by making the use of such facilities illegal.

Second, even if access to international information technology is not deliberately restricted, systematic large-scale exploitation of the opportunities for economic globalization created by the availability of cheap information can be severely hampered simply by imposing traditional barriers (tariff and non-tariff) on merchandise trade, by erecting obstacles to the international movement of persons (via tougher immigration laws and restrictions on working), by deterring the inflow of foreign funds (through denying legal protection to foreign owners of capital engaged in financial or direct investment), by restricting trade in services (through denying market access to foreign suppliers), and by obstructing the commercial trade in information-related services (through refusing to recognize intellectual property rights).

In other words, the massive strides made in globalizing over recent years could not have been taken had all governments been wedded to illiberal, anti-globalization philosophies. The potential of the technological revolution alone was not enough to guarantee the advent of globalization. A crucially important factor in securing the co-operation with the globalization of most governments, including those of developing countries, has been the active encouragement (through pursuing policies of deregulation) of the process provided by some of the larger Western countries, together with prompting, even arm-twisting, by powerful international agencies, notably the WTO, the IMF and the World Bank – that owe their origins to the same countries.

Self-Assessment Exercise 1

1. The political will to embrace or encourage the use of modern technology is necessary to step up the pace of globalization in developing countries. Discuss

2.4 Technology and Globalization

Central to the feasibility of the 'new' globalization is the advent of several major technological innovations applicable to information technology. Particularly important is the use of ever more efficient microprocessors to make possible much faster and much cheaper digital computing. This, together with associated advances in fibre optics and electronic switching devices, has simultaneously greatly speeded up telecommunications and simplified and vastly expanded information-exchange possibilities over long distances while radically reducing communication and data-processing costs. Also, the use of satellite communication technology has ensured that no part of the globe with a significant population is outside the range of mobile telephone services or the World Wide Web.

Specific examples of the globalizing effects of these technological innovations are:

- The use by manufacturers, especially the larger multinational corporations, of large amounts of information to adjust product characteristics to better suit market demand, streamline the paperwork associated with transactions, and coordinate, and optimize, the joint activities of branches and affiliates, however widely dispersed across a country or the globe.
- The application of computer-based automation to production processes, typically in design and process control, to speed them up, make them more accurate, and cut costs.
- The use by consumers of web-based information sources to improve their access to information on the range of product choices and prices. Given the radical reduction, or elimination, of barriers to international merchandise trade, this can effectively integrate domestic and foreign consumer-goods markets, and significantly affect buying habits.

- In the labour market the much-improved flows of up-to-date information on job vacancies and job-seekers, covering much larger populations than heretofore, and crossing national boundaries to include overseas populations.

3.4.1 Transportation

Improved, cost-reducing technologies interacting with privatization and deregulation, and increasing consumer affluence, have made air travel a cheap, mass-market phenomenon and air-freighting a genuinely competitive means of opening up distant markets for high-value products. At the same time, the steady advance of sea-freight technology has led to continuing and significant reductions in the real cost of transporting goods by sea.

Self-Assessment Exercises 2

1. Describe how the new globalization is the advent of several major technological innovations applicable to information technology
2. Illustrate the role of transportation in the globalization process

2.5 International Organizations and Globalization

The process of globalization has been supported and promoted by a range of international economic institutions which have, in many cases, gained additional global influence as a result of the process. Particularly significant among these are the World Bank, the International Monetary Fund (IMF), and the World Trade Organization (WTO). Other supra-national institutions, both official and emanating from civil society and NGOs have been – and may be in the future – influential in accelerating, or retarding, globalization.

The origins of all three of these organizations lie in the Bretton Woods Conference (officially styled The United Nations Monetary and Financial Conference) held in the Mount Washington Hotel in Bretton Woods, New Hampshire, US, in July 1944, just one year before the end of the Second World War. There a working group, headed by J.M. Keynes, drafted proposals for a body designed primarily to channel funds to repair the devastation done by the Second World War. This became the International Bank for

Reconstruction and Development. The activities of this institution were soon broadened to include providing financial assistance to developing countries, in which role it is better known as the World Bank.

A second working group, headed by Harry Dexter White of the United States, developed the terms of reference and format for an international monetary organization the purpose of which was to assist countries in reaching and maintaining, balance-of-payments equilibrium, and stability in the foreign-exchange markets. This became the International Monetary Fund (IMF). The Conference also proposed the creation of an International Trade Organization (ITO) to establish rules and regulations for international trade. Although the ITO's charter was later agreed upon at the UN Conference on Trade and Employment held in Havana, Cuba, in March 1948, it was not ratified by the US Senate. As a result, the ITO never came into existence. In its place, a much more modest undertaking, the General Agreement on Tariffs and Trade (the GATT) – an international treaty rather than an institution, aimed at removing or reducing tariff and non-tariff barriers to trade – was agreed upon. Many years later, in 1994-5, the Uruguay Round of GATT negotiations established the World Trade Organization (WTO), a body charged with extending and developing the GATT principles into a comprehensive, rules-based system for governing world trade, and administering the new, extended system.

The relevance of the World Bank and the IMF to globalization is two-fold. First, as the dominant source of policy advice (backed up with funding) as to how developing economies should be run, they have, to a greater extent induced a large number of developing countries to pursue parallel development strategies, thus in a sense globalizing their development philosophies. Secondly, their globalisation influence stems from their favouring deregulation and openness and integrating member economies into the global economy.

2.5.1 The World Bank

The World Bank began operations in 1945. Its main aim, initially, was to provide loans for the speedy rehabilitation of countries devastated by the Second World War. The first loan was made to France to finance a US$250 million purchase of machinery. From the outset, developing countries comprised a substantial proportion of the membership of the Bank, and it was always intended that development projects in these countries would become eligible for financing when the Bank's financial position permitted this. In the event, the advent of the Cold War brought the Marshall Plan, through which American funds were made available for European reconstruction on a scale far larger than could be contemplated by the Bank, so rendering its 'reconstruction' efforts largely redundant. This opened the way for a shift in the focus of its lending, and the first development loan was made in 1947 to Chile, to pay for electricity-generation equipment and agricultural machinery.

For some years thereafter the Bank acted very much as an orthodox commercial lender to developing-country governments. Its main attraction to the latter is its willingness to lend for development projects at unusually low-interest rates made possible by its non-profit status, coupled with its ability to borrow cheaply from the international capital market because of its triple-A credit rating. The latter was achieved because of the perceived official character of the Bank, which meant that lending to it was very low risk. A further reason for the low-interest rates charged by the Bank was that the risk of default on loans that it made was also assumed to be very low so the Bank itself charged a minimal risk premium on these loans.

However, from around 1960, when its affiliate, the International Development Association (IDA), was founded to provide low- (or zero-) interest-rate loans, and grants, to low-income countries, the Bank shifted progressively towards its present position as a development institution willing to fund projects and technical assistance in a very wide range of areas, including the social and humanitarian, and now heavily committed to pursuing the Millennium Development Goals of poverty reduction and sustainable development. By 2008 the Bank had increased its membership to 185 countries, had around 1800 ongoing projects (covering virtually every developing country) and an annual disbursement of development funds of the order of US$24 billion. To this figure must be added the project aid provided by the International Finance Corporation (IFC) – another affiliate, formed in 1956 to promote private enterprise (at a time when state finance tended to dominate investment in the developing world).

The World Bank now has two further associates. The Multilateral Investment Guarantee Agency (MIGA) supports direct foreign investment by offering insurance against the adverse financial effects of political turmoil. And the International Center for Settlement of Investment Disputes mediates in cases of dispute between foreign investors and host countries.

2.5.2 The International Monetary Fund (IMF)

The Articles of Agreement of the IMF defined its objectives as being 'To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and the development of the productive resources of all members. This was to be done by promoting international monetary cooperation through a permanent institution providing the machinery for consultation and collaboration on international monetary problems. Promoting exchange stability and orderly exchange arrangements, while seeking the elimination of restrictions on any foreign-exchange transactions hindering the growth of world trade, were important elements in its programme, as was the setting up of a multilateral system of payments in respect of current transactions between members. The Fund would also help members to achieve relatively speedy removal of balance-of-payments disequilibria – without resorting to measures destructive of national or international prosperity – by making the resources of the Fund temporarily available to them under adequate safeguards (IMF, 1945).

In return for financial assistance, countries making use of the services of the IMF are usually required to agree in advance to certain conditions regarding policy changes (conditional terms). These may be extensive, possibly including the adoption of the structural adjustment programmes (SAPs) aimed at removing the underlying fiscal, monetary or political causes of the troublesome imbalances such as large and persistent budget deficits, severe inflation, and counterproductive official intervention in the foreign exchange market.

2.5.3 The World Trade Organization (WTO)

The World Trade Organization (WTO) is the globalizer par excellence. Its creation, as the successor to the GATT, was announced in the Marrakesh Declaration of 15 April 1994. This marked the successful conclusion of the long-drawn-out Uruguay Round of multilateral negotiations on removing barriers to international trade. The conclusion of the Round and the setting up of the WTO were seen by the Ministers of the countries involved as a historic achievement. . . They believed it will strengthen the world economy and lead to more trade, investment, employment and income growth throughout the world.

The key features of the new WTO were the stronger and clearer legal framework . . . adopted for the conduct of international trade [in goods] . . . and the establishment of a multilateral framework of disciplines for trade in services and the protection of trade-related intellectual property rights. The truly worldwide coverage and influence of the new organization were emphasized in the Declaration which foresaw a new era of global economic cooperation . . . [and] greater global coherence of policies in the fields of trade, money and finance, including cooperation between the WTO, the IMF and the World Bank. By the end of 1995 the WTO had 112 members and by July 2008 membership had reached 153 (of which 32 were least-developed). A further 30 countries were engaged in the accession process. Thus total membership was heading for at least 183 - very close to the total membership of the United Nations (at 192 in 2008). Like the UN General Assembly and unlike the World Bank and the IMF, the WTO operates a one-country-one vote system.

The basic principles upon which much WTO regulation of trade and associated activities are based are the most favoured nation (MFN) principle – which requires that any concession offered by one member country to a second member country (the most favoured nation) must also be offered to all other member countries (irrespective of whether or not they have been parties to the negotiations between the first two parties) – and the national treatment principle which bans discrimination in favour of local nationals and against foreigners in trade-related activities.

Self-Assessment Exercises 3

1. Highlight the role of IMF in financial globalization
2. How important is the World Bank to economic globalization

2.6 Decision-Making by the World Bank and the IMF

Voting power on the Boards of the World Bank and the IMF is determined, not on the UN system of one country one vote, but in proportion to the respective financial contributions (quotas) of each country. The IMF's Articles of Agreement do not indicate precisely how these quotas are to be determined. However, in practice, they are set, for both institutions, relative to the approximate economic sizes of the different member countries. In 2008 the US (which traditionally provides the President of the Bank) had approximately 17% of the total voting power and, as a consequence was, as it had been since 1945, the dominant decision-maker. Japan, Germany, the UK, France, Italy and Canada together had 28% of total voting power and were also influential in policy decisions. European influence has been further increased as a result of the convention of appointing a continental European as Managing Director of the Fund. A further 14 countries accounted for 27.1% of the votes. The remaining 164 countries – 89% of the total membership, and predominantly developing countries – had only 27.9% of the votes.

Thus, despite being the focus of the activities of the World Bank and the IMF and, in many cases, having been significantly influenced by these activities, developing countries have, over the years since the founding of the Bank and Fund, had little say in determining their policies. These have tended to be set by (primarily) the US, and the wealthier European economies plus Japan. However, a package of reforms to be implemented by 2008 provides for both significant ad hoc increases in the quotas of the most underrepresented members (China, Korea, Mexico, and Turkey), and the introduction of a new formula for determining quotas based on four variables – GDP, openness, reserves, and variability of current-account aggregates. The overhauling of the formula is seen as providing an important step towards reform of the governance of the IMF and the World Bank, as the rebalancing of quota shares will better reflect the current relative weight of member countries in the world economy and strengthen the voice and participation of low-income members.

Self-Assessment Exercises 4

1. Discuss the decision-making arrangements by the World Bank and the IMF

2.7 Summary

In this unit, we discussed technology as a means of globalization. Globalization policy, international organization and globalization, the IBRD/World Bank, the IMF and how decision-making an arrangement by the World Bank and the IMF. Experts generally acknowledge globalization brings both benefits and risks which must be managed. More tightly integrated global economic markets carry greater potential for global recessions if countries are not able to work together to implement effective economic policies that reduce that risk. However, we can conclude that globalization and international organization have also brought new techniques and innovations in trade policy in the world.

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2.9 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). The political will to embrace or encourage the use of technology is necessary for the pace of globalization to be stepped up radically. While the availability of the Internet and satellite-communication technology have made possible for the first time easy and cheap communication over long distances; the actual making use of the opportunities so created can be made difficult by the government. Second, even if access to international information technology is not deliberately restricted, systematic large-scale exploitation of the opportunities for economic globalization created by the availability of cheap information can be severely hampered simply by imposing traditional barriers on trade, by erecting obstacles to the international movement of persons, by deterring the inflow of foreign funds, etc.

Answers to SAEs 2

1). The new globalization is the advent of several major technological innovations applicable to information technology through the use of more efficient microprocessors to make possible much faster and much cheaper digital computing. This, together with associated advances in fibre optics and electronic switching devices, has simultaneously greatly speeded up telecommunications and simplified and vastly expanded information-exchange possibilities over long distances while radically reducing communication and data-processing costs. Also, the use of satellite communication technology has ensured that no part of the globe with a significant population is outside the range of mobile telephone services or the World Wide Web.

2). Technology encourages globalization because improved, cost-reducing technologies interacting with privatization and deregulation, and increasing consumer affluence, have made air travel a cheap, mass-market phenomenon and air-freighting a genuinely competitive means of opening up distant markets for high-value products. At the same time, the steady advance of sea-freight technology has led to continuing and significant reductions in the real cost of transporting goods by sea. All of these have facilitated interactions among people and encouraged globalization.

Answers to SAEs 3

1). The IMF through its article of Association defined its objectives which are achieved by promoting international monetary cooperation through a permanent institution providing the machinery for consultation and collaboration on international monetary problems. It promotes exchange stability and orderly exchange arrangements while seeking the elimination of restrictions on any foreign-exchange transactions hindering the growth of world trade. An important element in its programme was the setting up of a multilateral system of payments in respect of current transactions between members. The Fund would also help members to achieve relatively speedy removal of balance-of-payments disequilibria – without resorting to measures destructive of national or international prosperity.

2). The World Bank initially provided loans for the speedy rehabilitation of countries devastated by the Second World War. From the outset, developing countries comprised a substantial proportion of the membership of the Bank, and it was always intended that development projects in these countries would become eligible for financing when the Bank's financial position permitted this. In the event, the advent of the Cold War brought the Marshall Plan, through which American funds were made available for European reconstruction on a scale far larger than could be contemplated by the Bank, so rendering its 'reconstruction' efforts largely redundant. This opened the way for a shift in the focus of its lending, and the first development loan was made in 1947 to Chile, to pay for electricity-generation equipment and agricultural machinery. For some years thereafter the Bank acted very much as an orthodox commercial lender to developing-country governments. Its main attraction to the latter is its willingness to lend for development projects at unusually low-interest rates made possible by its non-profit status, coupled with its ability to borrow cheaply from the international capital market because of its triple-A credit rating.

Answers to SAEs 4

1). The voting power on the Boards of the World Bank and the IMF is determined, not on the UN system of one country one vote, but in proportion to the respective financial contributions of each country. The contributions are set, for both institutions, relative to the approximate economic sizes of the different member countries. The US had approximately 17% of the total voting power and is the dominant decision-maker since 1945. Japan, Germany, the UK, France, Italy and Canada together had 28% of total voting power and were also influential in policy decisions. About 14 countries accounted for 27.1% of the votes and the remaining 164 countries – 89% of the total membership, and predominantly developing countries – had only 27.9% of the votes. Thus, developing countries have, over the years since the founding of the Bank and Fund, had little say in determining their policies. These have tended to be set by (primarily) the US, and the wealthier European economies plus Japan. Since 2008, the reforms provide for the introduction of a new formula for determining quotas based on four variables – GDP, openness, reserves, and variability of current-account aggregates.

UNIT 3 INTERNATIONAL TRADE

Unit Structure

3.1. Introduction
3.2. Learning Outcomes
3.3. International Trade and Trade Liberalization
3.4. The Dynamic Gains from Trade
3.5. Potential Costs Resulting from Trade
3.6. Effects of Trade Liberalization on Growth and Poverty
3.7. Summary

3.8. References/Further Readings/Web Resources

3.9. Possible Answers From Self-Assessment Exercises (SAEs) with the Content

3.1 Introduction

I know you may be wondering, what is meant by international trade. When you hear the word international trade, what comes to your mind? A layman on the street may conclude that international trade is a trade between two international countries. They may be right or wrong, this is what we are going to find out by the end of this unit. In this unit, we will also discuss the gains from trade as well as the effects of trade liberalization on economic growth and poverty.

3.2 Learning Outcomes

By the end of this unit, you will be able to:

- Define and explain the meaning of international trade
- Describe the meaning of the dynamic gains from trade
- Highlight the impact of trade liberalization on growth and poverty.

3.3 International Trade and Trade Liberalization

What do you understand by international trade? We can define international trade as the exchange of capital, goods, and services across international borders or territories (Kiziltan, 2021). It is the exchange of goods and services among nations of the world. In most countries, such trade represents a significant share of gross domestic product (GDP). While international trade has existed throughout history its economic, social, and political importance has been on the rise in recent centuries. If you walk into a supermarket in Nigeria and can buy South American bananas, Brazilian coffee and a bottle of South African wine, know that these are possible through international trade.

International trade allows us to expand our markets for both goods and services that otherwise may not have been available to us. It is the reason why you can pick between a Japanese, German or American car. As a result of international trade, the market contains greater competition and therefore more competitive prices, which brings a cheaper product home to the consumer. Trading globally allows consumers and countries to be exposed to new markets and products. Almost every kind of product can be found on the international market: food, clothes, spare parts, oil, jewellery, wine, stocks, currencies and water. Services are also traded: tourism, banking, consulting and transportation. A product that is sold to the global market is an export, and a product that is bought from the global market is an import. Imports and exports are accounted for in a country's current account in the balance of payments

The most straightforward manifestation of globalization is increased international trade (henceforth simply trade). The dismantling of tariffs, and other barriers to commerce between nations and the moves (however halting) toward a single, integrated world market for goods and services, may be expected to lead to a significant increase in the magnitude of world trade. The potential gains to developing countries from deregulating trade are conventionally divided into two components – static efficiency gains, and dynamic gains. These are discussed below:

Static efficiency gains from trade: Ricardo's comparative advantage theory

The possibility that welfare gains may be had by adopting a free-trade regime is the central conclusion flowing from David Ricardo's celebrated comparative-advantage model. Consider two countries – one a high-income country, the other a lower-middle-income country. For convenience, we will call them Ghana and Nigeria. Now make the grossly simplifying assumptions that both countries produce only two goods – maize and cement – and that, in both cases, the sole input is labour. The hypothetical production costs for the two goods in the two countries are expressed in Table 1 in terms of labour inputs per ton of output.

Table 1: Hypothetical Costs of Production of Maize and Cement in Nigeria and Ghana

Commodity	Units of labour input/ton output Nigeria	Units of labour input/ton output Ghana
Maize Cement	6 24	1 2
Relative price (tons maize per ton cement)	4	2

From Table 1, we assume that the product prices are set for the respective labour inputs. In Nigeria, 1 ton of cement (24 units of labour) would exchange for 4 tons of maize (24 units of labour); that is, the price of 1 ton of cement is 4 tons of maize. In Ghana, 1 ton of cement would exchange for 2 tons of maize. Using a simple example of this sort Ricardo demonstrated that despite the - at first sight – unattractive nature of Nigerian products to Ghanaian consumers because of their higher unit cost in terms of labour input (bearing in mind that in this simple model labour is the only factor of production), will be to both countries' advantage to trade.

Note that, in both industries, production in Ghana is more efficient than in Nigeria because the labour input per ton output is lower in Ghana than in Nigeria. Note also that, despite being at an absolute disadvantage in maize production, Nigeria has a relative or comparative advantage in maize production because it is 'less bad' at producing it. So, if the two economies are open to international free trade, Ghana would see Nigerian maize as a bargain (exporting 1 ton of cement they get 4 tons of Nigerian maize – whereas at home they get only 2 tons of maize). At the same time, Nigerians see Ghanaian cement as a bargain (exporting 4 tons of their maize they get 2 tons of cement – instead of only 1 ton). Put another way, importing both trading partners reduce the opportunity cost of obtaining the imported good.

Given this new Ghanaian demand for its maize, Nigerian producers of cement would shift resources into maize production. In Ghana, the reverse would happen as Ghanaian cement production expands to satisfy the new demand from Nigeria. This move in the direction of specialization would affect global supply and demand and would thus very probably affect product prices, raising the price of Nigerian maize and the price of Ghanaian cement. The final, equilibrium price ratio, in effect now the world price ratio, or the world terms of trade, would lie somewhere between the two pre-trade price ratios, for instance at 3 tons of maize per ton of cement.

What is the outcome of this process? The key conclusion is that both countries are better off with international free trade than without it because of the so-called static gains from trade flowing from specialization. Nigerians can now import from Ghana the same number of tons of cement as they bought before trade began, but at a smaller sacrifice in terms of maize given up. The Ghanaians are in a similar position, with less cement sacrificed to get any particular amount of maize. This also means that specialization and trade have increased total (world) production. However, this simple model cannot tell us how the gains from trade will be divided between the two countries – a potentially important issue.

Neoclassical development of the law of comparative advantage: the basic classical law of comparative advantage discussed above hinges on the assumption that labour productivities, though fixed in any one country for the production of a given commodity, differ across countries for the production of that commodity. If these fixed productivities happen to be the same across countries, or in the same ratio – in our example, if Ghana required 4 units of labour to produce one unit of cement – relative productivities, and therefore price ratios, would be the same so there would be no incentive to trade.

A more flexible, neoclassical development of the Ricardian model – the Heckscher-Ohlin model (Ohlin, 1933) allows for differences in relative factor endowments across countries. These result in different relative prices of factors internationally. Relatively capital-abundant countries will have relatively cheap capital, and relatively labour-abundant countries will have relatively cheap labour. As a result, the former group of countries, which will tend to be high-income countries, will have a cost advantage in the production of relatively capital-intensive goods and will tend to specialize in and export them. Countries which are relatively labour-rich (mainly developing countries) will tend to specialize in and export relatively labour-intensive goods. Thus, differences in factor endowments rather than differences in labour productivity or differences in technologies available to countries become the source of differences in relative product prices and hence of trading opportunities.

Important conclusions derived from the Heckscher-Ohlin theorem are:

- Specialization by countries in making and exporting those goods which use their relatively abundant factor relatively intensively in production results in static welfare gains.
- Since relatively capital-intensive goods tend to be the more sophisticated manufacturers and since relatively labour-intensive goods tend to be agricultural goods and basic manufacturers; production and exporting of the former kinds of goods will tend to be concentrated in developed countries. While the production and exporting of the latter kinds of goods will tend to be concentrated in developing countries.
- The process of specialization referred to in the previous paragraph will tend, in each country, to increase demand for the relatively abundant factor. So the price of capital will tend to rise relative to that of labour in the capital-rich (developed) countries, and the price of labour will tend to rise relative to that of capital in the labour-rich (developing) countries. Put another way – relative factor prices will tend to converge in developed and developing countries (this is, the factor price equalization theorem). This also means that the relatively scarce factor in each country will tend to lose as a result of the opening of trade; that is, labour will lose in capital-rich/labour-poor developed countries and capital-owners will lose in developing countries. However, the dynamic gains from trade may well outweigh these specific losses. (see discussion below)

Self-Assessment Exercises 1

1. Describe what is meant by international trade
2. What can we deduce from the Heckscher-Ohlin theorem

3.4. The Dynamic Gains from Trade Liberalization

In addition to reaping the static gains accruing from engaging in international trade, participating countries may benefit from additional dynamic gains – which could well be much more significant than the static gains. Such gains may take the form of:

- The opportunity for firms to benefit from economies of scale through access to markets larger than the domestic ones, especially if production is subject to increasing returns. Even in developing countries with fairly large populations, low per capita incomes can make the local markets effectively small.
- Improvements in the efficiency of firms' performance. These may arise for several reasons: the need to cut costs to survive in the more competitive international economy; the improvement in products, production processes and managerial systems resulting from contact (competitive or collaborative) with outside firms; and the acquisition of knowledge.
- Exchange of exports for imported resources to be used in producing other goods. Where these imported resources are more productive than the domestic alternative, they can improve overall efficiency thus permitting expansion of the production possibility curve (PPC).
- Use by export industries of imported technologies that permit learning by the labour force which may be transferred to other occupations and again expand the PPC outwards.
- Increases in exports may make possible increased imports of food and medicinal products. Aside from their humanitarian benefits, these new imports are likely to improve the health of the population and thus improve the productivity of the labour force.

Many analysts believe that the favourable effects resulting from expanding trade under a regime of globalization will have important pro-development consequences. It seems likely that improvements in productivity made possible by the combination of the static and dynamic efficiency gains from trade will accelerate growth. The gains from specialization along lines indicated by comparative advantage, together with the multi-faceted dynamic gains from trade liberalization will result in accelerated growth which in turn, generates higher standards of living, reductions in the incidence of poverty, and improvements in income distribution.

Self-Assessment Exercise 2

1. Explain the dynamic gains from trade

3.5 Potential Costs Resulting From Trade Liberalization

Although the overall impact is expected to be favourable, trade liberalization can inflict costs on some individuals and some sectors of economic activity. Indeed, it is almost inevitable that in the short term, at any rate, there will be losers as well as gainers due to economic restructuring which usually follows liberalization. Specific problems may include:

- Increased unemployment and failure of domestic firms because of intensified competition from imports. In small economies with few alternative employment opportunities, some of the older displaced workers may have to resign themselves to being unemployed for the rest of their lives.
- Localized increases in poverty in communities or regions, particularly badly hit by competition from imports.
- Deterioration in income distribution in the period of adjustment following liberalization as some industries expand rapidly while others decline as increased levels of unemployment and poverty persist.
- Diminished enthusiasm on the part of governments for the introduction or continuation of measures such as statutory minimum wages may erode competitive advantage in export markets.

- Relegation to a low-growth trajectory. The comparative advantage of some developing countries lies in non-dynamic goods. The production of such goods offers few opportunities for improving efficiency by upgrading technology or by learning by doing on the part of the labour force – and demand for which is slow-growing or declining. In such cases, trade liberalization may bring to bear market forces, trapping countries in the production of these goods. Growth is likely to be weak or non-existent in such situations. A variant of this argument was advanced to justify protective import-substituting interventions to change the comparative advantage of developing countries; behind tariff barriers. It is argued that local industries might become more efficient by taking advantage of dynamic scale benefits and opportunities for ‘learning by doing.
- Erosion of local political sovereignty. The encroachment by the WTO on local legislative autonomy in areas such as trade barriers, business taxation, technical, and sanitary and phytosanitary regulations relating to traded goods, and support confined to local firms producing traded goods, seems to many citizens of developing countries to infringe local sovereignty. The impression created is that national governments in the developing world shape their economic policies along lines set by international agencies on behalf of the US or European countries without reciprocity. Such elected national governments are seen as impotent, having influence neither in their own countries nor in the developed world which moulds their policies. This is what Stiglitz called a ‘democratic deficit.
- Adverse environmental impacts. It is frequently claimed that globalization of trade and environmental deterioration are linked. This allegation can refer simply to the possibility that increases in trade resulting from globalization give rise to increased production and hence more pollution. It may be argued that removing restrictions on the freedom of manoeuvre of multinational corporations enables some to relocate pollution-intensive processes in countries where pollution controls are weak – probably the developing countries.

Self-Assessment Exercise 3

1. Write the potential costs resulting from trade liberalization

3.6 Effects of Trade Liberalization on Growth and Poverty

The impact on the growth of liberalizing trade has been one of the most worked-over topics in the debate on globalization. The same topic was regularly analyzed long before the advent of current globalization but, as the context is now markedly different, it is instructive to consult the more recent contributions to the literature. Here, our discussion is based on the results of two major studies: Dollar and Kraay (2004); Frankel and Romer (1999).

Given the breadth and vigour of the attacks on globalization over this issue, it may seem a little unfair of Dollar and Kraay to open their influential analysis with what amounts to a pre-emptive strike on the credentials of critics. Openness to international trade accelerates development and is one of the most widely held beliefs in the field of Economics. However, it is the case that the balance of academic opinion on the matter favours the views that trade liberalization usually leads to increased trade (this proposition is not the subject of serious dispute) and that increases in trade resulting from liberalization make a significant contribution to economic growth and hence to development.

The Dollar and Kraay study analyzed a group of globalized – developing countries which, post-1980, markedly increased their ratio of trade to GDP and/or significantly reduced their average import tariff rates – and compared their economic performance with that of non-globalizing developing countries. The key findings were that the rate of economic growth in the globalized (including China and India) increased from the 1970s through to the 1990s, while the developed countries and the non-globalizing developing countries experienced falling growth rates over the same period. For instance, in the 1990s the globalizing developing countries grew at 5.0% per capita; rich countries at 2.2% per capita; and non-globalizing developing countries at only 1.4% per capita. Thus the globalizers are catching up with the rich countries while the non-globalizers fall further and further behind. These Dollar and Kraay findings are supported by the results of many other studies.

Frankel and Romer, using a gravity model and a sample of 63 countries found a substantial positive relationship between trade and income growth such that increasing the ratio of trade to GDP by one percentage point raises income by between one-half and two per cent. Sachs et al. (1995); Dollar (1992); Winters (2004); Ades and Glaeser (1999) use evidence based on the experience of laggard areas in the nineteenth-century American economy to show that backwardness and openness can be (or rather, have been) an effective combination of characteristics favouring growth. This area of analysis poses particularly tricky analytical problems because of the difficulty experienced in separating statistically the effects on growth of measures affecting trade from the effects on growth of other measures or characteristics – an identification problem. Thus countries with bad macroeconomic policies and weak institutions also have severe trade restrictions. And when countries liberalize their trade regimes, it typically takes place along with a macroeconomic stabilization programme (Hsieh, 2000). In other words, measures of the extent of openness or outward orientation, or integration into the world economy or trade liberalization used in analysis often capture the effects of other policies or country characteristics as well. Notable examples of criticism of statistical methodology in this context are to be found in the attack on the Dollar and Kraay study by Nye and Reddy (2002) and the more general broadside by Rodriguez and Rodrik (2000).

However, it does seem that the weight of the evidence supports the by-now conventional view that trade is good for growth. (Kose et al., 2006). Lindert and Williamson (2001) certainly believe so. They offer a useful (if not wholly scientific) corrective to excessive preoccupation with fine points of statistical technique in the face of what seems, at the intuitive level, to be overwhelming evidence in favour of the existence of a positive link between trade and growth. Thus it seems safe to assume that in many countries, globalization has increased trade – which has, in turn, increased growth rates.

3.6.1 Does liberalizing trade reduce the incidence of poverty?

Turning to the impact of liberalizing trade on poverty, the picture is less clear. Although it might seem likely at the intuitive level that the increased growth resulting from trade liberalization will lead to reductions in poverty levels in developing countries it is necessary to bear in mind that the changes associated with liberalization create losers as well as winners. It is, then, disappointing that no robust evidence has thus far been found linking trade liberalization directly to overall reductions in poverty. Until harder evidence – either way – is available, we must content ourselves with the indirect finding that, since trade-driven growth does not seem to affect income distribution in developing countries, the poor are probably better off in absolute terms as a result of liberalization – since they retain a constant share of an expanding cake. Or, as Dollar and Kraay (2004, p. 27) put it: ‘There is no systematic relationship between changes in trade volumes and changes in household income inequality. The increase in growth rates that accompanies expanded trade therefore on average translates into proportionate increases in income of the poor.

Self-Assessment Exercise 4

1. Discuss the impact of trade liberalization on growth and poverty

3.7 Summary

In this unit, we described international trade as the exchange of goods and services between countries. This type of trade gives rise to a world economy in which prices or supply and demand affect and are affected by global events. Trading globally allows consumers and countries to be exposed to goods and services not available in their own countries. Almost every kind of product can be found on the international market: food, clothes, spare parts, oil, jewellery, wine, stocks, currencies and water. Services are also traded: tourism, banking, consulting and transportation. Export and import are accounted for in a country's current account in the balance of payments. This unit also looked at the dynamic gains from trade, potential costs resulting from trade liberalization, and the impact of trade liberalization on growth and poverty. We may conclude that increases in trade resulting from liberalization make significant contributions to economic growth and hence to the development of an economy.

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3.9 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). International trade is the exchange of capital, goods, and services across international borders or territories. It is the exchange of goods and services among nations of the world. In most countries, such trade represents a significant share of gross domestic product (GDP).

2). Important conclusions we can derive from the Heckscher-Ohlin theorem are:

(i). Specialization by countries in making and exporting those goods which use their relatively abundant factor relatively intensively in production results in static welfare gains.

(ii). Production and exporting of capital goods will tend to be concentrated in developed countries while the production and exporting of agricultural goods will tend to be concentrated in developing countries. This is because relatively capital-intensive goods tend to be the more sophisticated and relatively labour-intensive goods tend to be agricultural goods.

(iii). The process of specialization will tend to increase demand for the relatively abundant factor. So the price of capital will tend to rise relative to that of labour in the capital-rich (developed) countries, and the price of labour will tend to rise relative to that of capital in the labour-rich (developing) countries. In other words, relative factor prices will tend to converge in developed and developing countries (this is, the factor price equalization theorem). This means that the relatively scarce factor in each country will tend to lose as a result of the opening of trade.

Answers to SAEs 2

1). The dynamic gains from international trade include:

(i). The opportunity for firms to benefit from economies of scale through access to markets larger than the domestic ones, especially if production is subject to increasing returns.

(ii). Improvements in the efficiency of firms' performance due to the need to cut costs to survive in the more competitive international economy; the improvement in products, production processes and managerial systems resulting from contact with outside firms; and the acquisition of knowledge.

(iii). Exchange of exports for imported resources to be used in producing other goods. Where these imported resources are more productive than the domestic alternative, they can improve overall efficiency thus permitting expansion of the production possibility curve (PPC).

(iv). Use by export industries of imported technologies that permit learning by the labour force which may be transferred to other occupations and again expand the PPC outwards.

(v). Increases in exports may make possible increased imports of food and medicinal products. Aside from their humanitarian benefits, these new imports are likely to improve the health of the population and thus improve the productivity of the labour force.

Answers to SAEs 3

1). The costs of engaging in international trade include:

(i). Increased unemployment and failure of domestic firms due to competition from imported products.

(ii). Localized increases in poverty in communities or regions, particularly badly hit by competition from imports.

(iii). Deterioration in income distribution in the period of adjustment following liberalization as some industries expand rapidly while others decline as increased levels of unemployment and poverty persist.

(iv). Relegation to a low-growth trajectory. The comparative advantage of some developing countries lies in non-dynamic goods. The production of such goods offers few opportunities for improving efficiency by upgrading technology or by 'learning by doing on the part of the labour force – and demand for which is slow-growing or declining.

(v). Erosion of local political sovereignty. The encroachment by the WTO on local legislative autonomy in areas such as trade barriers, business taxation, and regulations relating to traded goods. It is believed that national governments in the developing world shape their economic policies along lines set by international agencies on behalf of the US or European countries without reciprocity.

(vi). Adverse environmental impacts. Increases in trade resulting from globalization give rise to increased production and hence more pollution. It may be argued that removing restrictions on the freedom of manoeuvre of multinational corporations enables some to relocate pollution-intensive processes in countries where pollution controls are weak – probably the developing countries.

Answers to SAEs 4

1). Turning to the impact of liberalizing trade on poverty, the picture is less clear. Although it might seem likely at the intuitive level that the increased growth resulting from trade liberalization will lead to reductions in poverty levels in developing countries it is necessary to bear in mind that the changes associated with liberalization create losers as well as winners. As trade-driven growth does not seem to affect income distribution in developing countries, the poor are probably better off in absolute terms as a result of liberalization

UNIT 4 INTERNATIONAL FINANCIAL FLOWS

Unit Structure

4.1. Introduction
4.2. Learning Outcomes
4.3. Meaning and Types of International Financial Flows
4.4. Financial Globalization: What is Being Deregulated?
4.5. Globalizing Financial Flows: Potential Costs and Benefits
4.6. Collateral Benefits from Capital Inflows
4.7. Summary
4.8. References/Further Readings/Web Resources

4.9. Possible Answers to Self-Assessment Exercises (SAEs) with the Content

4.1 Introduction

International capital flows are the financial side of international trade. When someone imports a good or service, the buyer (the importer) gives the seller (the exporter) a monetary payment, just as in domestic transactions. If total exports were equal to total imports, these monetary transactions would balance at net zero, that is, people in the country would receive as much in financial flows as they paid out in financial flows. But generally, the trade balance is not zero. This unit discusses the meaning and types of international financial flows as well as the costs and benefits of financial globalization.

4.2 Learning Outcomes

By the end of this unit, you will be able to:

- Explain the meaning of international financial flows
- Identify the different types of financial flows
- Describe the potential benefits and costs of financial globalization

4.3 Meaning and Types of International Financial Flows

4.3.1 Meaning of International Financial Flows

The most general description of a country's balance of trade, covering its trade in goods and services, income receipts, and transfers, is called its current account balance. If the country has a surplus or deficit on its current account, there is an offsetting net financial flow consisting of currency, securities, or other real property ownership claims. This net financial flow is called its capital account balance. When a country's imports exceed its exports, it has a current account deficit. Its foreign trading partners who hold net monetary claims can continue to hold their claims as monetary deposits or currency, or they can use the money to buy other financial assets, real property, or equities (stocks) in the trade-deficit country. Net capital flows comprise the sum of these monetary, financial, real property, and equity claims. Capital flows move in the opposite direction to the goods and services trade claims that give rise to them. Thus, a country with a current account deficit necessarily has a capital account surplus.

In BALANCE-OF-PAYMENTS accounting terms, the current account balance (total balance of internationally traded goods and services) is just offset by the capital account balance, which is the total balance of claims that domestic investors and foreign investors have acquired in newly invested financial, real property, and equity assets in each other's countries. The capital account is the mirror image of the current account, one expects total recorded world trade exports plus imports summed over all countries to equal financial flows payments plus receipts. The data on international trade and financial flows are generally riddled with errors, generally because of undercounting. Therefore, the international capital and trade data contain a balancing error term called "net errors and omissions."

4.3.2 Types of International Financial Flows to Developing Countries

(a) Portfolio investment (equity and bonds) - Equity portfolio foreign investment (PFI) refers to the purchasing of shares in a company as an indirect investment. That is a purely financial investment not related to the control of the company. It is thus unlike the foreign direct investment carried out by MNCs, which brings with it participation in management and control of the company. Bonds sold by developing-country governments and corporations to foreign buyers are also classed as portfolio investments.

(b) Commercial-bank lending - Commercial banks involved in international finance lend to foreign governments, firms and individuals. They may do so at arm's length from bank offices in their home countries (technically international banking) or, increasingly, from branches set up abroad, often in the countries in which their borrowers reside or operate (multinational banking).

(c) Foreign direct investment - Foreign direct investment (FDI) is an investment, usually by a multinational corporation (MNC), which involves the investor in active participation in the productive activity being financed – generally by operating the production facility. FDI flows to developing countries qualify as an aspect of globalization in two ways. First and most obviously, an act of direct foreign investment represents the extension of the activities of a firm into the international arena. Moreover, for the larger MNCs which provide the vast bulk of FDI (and over one-third of total global exports) acts of overseas investment are very often integral parts of global corporate strategies.

Second, the expansion of FDI may be seen, in part, as a response to the promotion of globalization by the WTO. The latter seeks to create, as nearly as possible, a global level playing field for all investors – local or foreign – by removing discrimination against incoming MNCs on the part of host governments. The present Agreement on Trade-Related Aspects of Investment Measures (TRIMs), goes some way towards this goal by barring member governments from discriminating between local and incoming foreign firms in the tax treatment of trade-related activities. It also bans certain devices aimed at restricting the operations of MNCs, for instance, requiring that incoming MNCs purchase a certain proportion of their inputs locally (local-content requirement) or restricting an MNC's purchase of imports to an amount equivalent to the level of its exports (trade-balancing requirement).

It is worth noting that, although discussion of the foreign-investment issue was dropped from the Doha Round agenda in 2004 to make room for discussion of less contentious issues, it seems likely that, in time, it will reappear- as the WTO continues to push towards a truly non-discriminatory 'globalized' framework for trade and investment.

(d) Migrants' remittances - The growth of migration and the counter-flow of remittances have been greatly facilitated by the interaction of several aspects of globalization. The sharp falls in the cost of international air transportation together with the improvement in international information flow about employment opportunities in other countries, now accessible to residents of developing countries through the Internet, have encouraged migration. In addition, improvements in the geographical coverage and reliability of international money transfer arrangements facilitate the process of regularly remitting funds between countries.

(e) **Foreign aid -** Official development assistance (foreign aid) is a significant component of financial flows to developing countries. Different international countries in the world give aid to assist the less developing ones to improve their economy.

(f) **Exports and imports of goods and commercial services -** Trade in goods and commercial services gives rise to flows of current-account expenditures (on imports) and receipts (from exports). The balance of these items – the 'balance of trade' – may be an important element in the overall net cash flow position of a developing country.

Self-Assessment Exercises 1

1. What is net errors and omissions?
2. List and discuss the different types of international financial flows available to developing countries.

4.4. Financial Globalization: What is Being Deregulated?

Deregulation which forms the basis of integration or globalization of financial markets is the removal of controls which affect international flows of capital directly through explicit administrative measures, or indirectly through market-based measures (Allen, 2016). The most commonly encountered direct measures include: specific limits on the value of capital transactions (including, in some cases, total prohibition), requirements that permission is granted by the authorities for capital transactions (usually above a certain amount), limits on the importing or exporting of currency and gold, rules governing the operation of cross-border bank accounts, regulations affecting the use or surrender of foreign exchange earned by exporters, controls on cross-border transactions in bonds, equities and other securities, restrictions on the granting of credit to non-residents, controls on the financial activities of incoming MNCs – including importing, exporting, funding and liquidation of investments, controls on expatriate transactions in real estate, and prudential regulation of financial institutions.

Market-based measures include the use of multiple exchange rates – with different rates for different uses of foreign exchange - and taxes on foreign-exchange transactions. (see IMF, (2007) for a comprehensive account of regulatory measures and the current status of legislation in all member countries). A large part of the deregulation of international financial markets involves the winding down of these regulatory measures.

Self-Assessment Exercises 2

1. Define the term deregulation
2. List the direct measures of deregulation
3. Identify the market measures of deregulation

4.5 Globalizing Financial Flows: Potential Benefits and Costs

(A) Potential benefits

Increased investment in developing countries*:* Standard neoclassical theory suggests that deregulation/globalization of capital markets should lead to more and cheaper capital becoming available to finance increased levels of investment in developing countries. Removing capital controls should lead to a major reorientation of capital flows toward capital-poor countries (that is, towards developing countries) where rates of return on capital should be relatively high. This improvement in the efficiency of resource allocation would benefit investors, but would also be of major potential benefit to developing countries in which local savings were inadequate. It would also benefit countries where local interest rates are high, as the incoming funds could be used to widen the capital base, increase the level of investment and thus accelerate economic growth. Additionally, increased overall investment (worldwide) should result from the broadening and deepening of the international capital base over which risks are spread. This effect, which is logically distinct from the reorientation of funds mentioned above should further augment capital stocks and growth potential in developing countries.

Upgrading financial systems*:* Increasing inflows of funds of different kinds into developing countries may generate collateral benefits – in particular by helping to develop the financial systems. This is expected by most commentators to be favourable to further improvement of growth prospects.

Reduction in instability of production and associated macroeconomic aggregates*:* The impact of globalization, working through increased inward flows of portfolio investment, commercial bank lending, and FDI, can improve stability of output, employment and incomes in some developing countries – especially countries at a relatively early stage of development – by broadening the production base.

For more advanced developing countries, increased investment resulting from globalization, by encouraging greater openness of trade and increased specialization along lines dictated by comparative advantage, can narrow the output base. This in turn can increase the risk of output instability, especially in small developing countries – and would, of course, be seen as a cost rather than a benefit.

(b) Potential costs

Capital flight: Abandoning controls on the outward movement of capital may encourage capital flight, as nervous owners of capital make use of the opportunity to move their funds abroad to earn higher returns, or simply to shift these funds to what they perceive to be more secure locations. Such manoeuvres narrow the resource base of the countries in which they occur.

Volatile inflows of capital: If flows of capital funds into a developing economy fluctuate widely from year to year, so giving rise to unpredictable variations in levels of investment, employment, incomes and budget revenues, problems may be created for both individual firms and workers and macroeconomic stabilization. Given the heterogeneous nature of these flows, their sources and their motivation, it would be surprising if there were no year-on-year variation. Given this, the important considerations are just how volatile these deregulated flows are and whether or not there are systematic differences in volatility across the different kinds of flow.

Financial crises/panics*:* Financial deregulation has also been identified as a contributory cause of financial crises in developing countries, being triggered by the volatile behaviour of certain financial flows. The core element of many financial crises is likely to be the sudden, large-scale withdrawal or liquidation of foreign-owned funds and financial assets **-** made easier by deregulation. Such crises often follow a characteristic pattern –heavy inflows of capital into a developing country are followed by the massive expansion of domestic credit and the creation of financial 'bubbles', which trigger a liquidation panic when they burst. The root cause of these crises is believed by some analysts to be market distortion. This takes the form of asymmetry in the extent and accuracy of the information available to lenders and borrowers, respectively, such that borrowers are better informed than lenders of the true nature of the risks associated with any given transaction. The reaction by lenders (who feel themselves to be relatively ill-informed), to a shift in market sentiment, may be excessive, going well beyond anything justified by the facts of the situation, and may be sufficient to spark off a chain reaction of herd instinct behaviour. Lack of or inadequacy of information is common throughout the financial world but is particularly prevalent in long-range deals between institutions in developed and developing countries. Cultural differences may exacerbate the problem, as the case may be greater difficulty experienced in enforcing contracts at a distance. Lack of information may make investors overreact to both good and bad news. In the former case, they display over-enthusiasm in investing; while in the latter they withdraw their funds more quickly and completely than market fundamentals would justify.

Both portfolio and commercial bank lending have been blamed for triggering financial crises. Debt flows are believed to be particularly sensitive to bad news in this context. They are easily reversible in a crisis in principle, making those developing countries that rely on them rather than on FDI for long-term investment finance much more vulnerable to negative shocks (Wei, 2006). Also, some analysts argue that commercial bank lending may be particularly prone to setting off panics since the lenders (banks) are highly leveraged and therefore particularly vulnerable and sensitive to threats of non-repayment (Dobson & Hufbauer, 2001).

It should also be noted that governments are alleged to have, in some cases, intensified financial panics. By assisting financial institutions under threat they may have exacerbated the situation by encouraging even more risky behaviour by these institutions – which now perceive themselves to be in a less vulnerable (perhaps invulnerable) position.

Self-Assessment Exercises 3

1. Explain succinctly three benefits of financial flows
2. List the potential costs of financial flows to the Nigerian economy.

4.6. Collateral Benefits from Capital Inflows

If adequate measures are taken to minimize the risk of financial crises arising in developing countries, integration into the global financial system can bring benefits not just from increased capital inflows but also from 'collateral' changes which may be triggered by these flows. Some scholars believe that such effects can, in the long run, have more important direct consequences for growth rates in developing countries than the effects of the financial inflows themselves. Moreover, the collateral changes may have favourable indirect feedback effects on growth by encouraging further increases in capital inflows. The changes may fall into one of three categories – development of the domestic financial sector, improvements in institutions (governance, the rule of law and so on) and improved macroeconomic policies. We now discuss these direct and indirect effects in turn.

4.6.1 How and why does financial globalization bring collateral benefits

Integration into the global financial system can bring benefits not just from increased capital inflows but also from 'collateral' changes which may be triggered by these flows. Such effects can in the long run have more important direct consequences for growth rates in developing countries than the effects of the financial inflows themselves. Moreover, the collateral changes may have favourable indirect feedback effects on growth by encouraging further increases in capital inflows. The ‘changes’ we are talking about here fall into one of three categories: (a) development of the domestic financial sector, (b) improvements in institutions (including governance, the rule of law, etc), and (c) improved macroeconomic policies. We will discuss these effects in detail:

(i) Financial globalization encourages improved performance by the domestic financial sector in developing countries in the following ways: - Foreign banks now find it easier to set up operations expected to yield the following benefits, in developing countries:

- There is now easier access to overseas international financial markets and hence enhanced inflows of funds at interest rates below those formerly prevailing domestically;
- The regulatory and supervisory frameworks used by the incoming banks are very likely to be superior to those used by domestic banks and will probably be emulated by the latter (to appear equally sound commercially to prospective customers);
- The introduction of new financial instruments and technologies and increased competition will improve the quality and range of financial services offered to customers, probably at a reduced cost;
- Foreign banks can provide an in-country home for funds when and if there are concerns about the solvency of domestic banks, so these funds do not have to be withdrawn from the local banking system altogether.

It should be noted that if the domestic banking sector is very small and weak, it could be wiped out by incoming foreign banks which might then lose interest in local small depositors and small businesses, with damaging effects on the local economy. Moreover, embarking on financial integration before strengthening domestic financial institutions could have serious adverse consequences, with deregulation of capital flows leading to net outward flows of funds (capital flight) and negative effects on growth prospects.

Globalization can also promote the deregulation of developing-country equity markets. This may be expected to lead to increased efficiency as these stock markets become larger and more liquid.

(ii) Financial globalization encourages improvement in institutions and governance (both corporate governance and broader public governance): - Corporate governance can be expected to improve with financial globalization because:

- Foreign investors often have the skills and information technologies that enable them to monitor the management of firms operating in developing countries better than can local investors.
- Domestic governments may be spurred to tighten up corporate governance systems in response to pressure exerted by international investors.

Public governance can be expected to improve because:

- Developing countries may find difficulty in attracting FDI and portfolio equity inflows which are in principle more readily available after globalization, unless and until they improve governance by taking effective action to curb corruption, cut red tape, improve the transparency of policies, and ensure the effective rule of law.
- Incoming banks and multinational companies are often large enough, have the resources and expertise, and are sufficiently ‘footloose’, to be able to challenge deviations by host governments from good governance practices. Smaller local firms wholly dependent on the domestic market may feel too vulnerable to mount such a challenge.

(ii) Financial globalization encourages improvement in macroeconomic policies: - Capital account liberalization makes a country more vulnerable to sudden shifts in global investor sentiment, it can serve as a signal of commitment to better macroeconomic policies (Kose et al., 2006). Thus, the opportunities offered by financial globalization may encourage governments of developing countries to make their economies more investor-friendly by strengthening their policies on inflation, moving towards a freer foreign-exchange market, and avoiding capricious changes in fiscal policy.

Self-Assessment Exercises 4

1. Financial globalization may encourage improved performance by the domestic financial sector in developing countries. Discuss
2. How can financial globalization encourage improvement in macroeconomic policies

4.7 Summary

In this unit, we discussed the type of international financial flows to developing countries, financial globalization, globalizing financial flows, and the collateral benefits from capital inflows. We can conclude that the international financial flow is also known as cash flow and is used to measure a country's financial health and status. The movements of finances are tracked by the cash receipts minus any of the cash payments that are being made over a given period or a set period made by that country. Integration into the global financial system can bring benefits not just from increased capital inflows but also from 'collateral' changes which may be triggered by these flows. The changes may fall into one of the three categories, namely development of the domestic financial sector; improvements in governance institutions and improvement in macroeconomic policies.

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4.9 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). Net errors and omissions: The data on international trade and financial flows are generally riddled with errors due to undercounting. Therefore, in international capital and trade data contain a balancing error term called "net errors and omissions."

2). Types of international financial flows to developing countries include:

(i). Portfolio investment (equity and bonds) - Equity portfolio foreign investment refers to the purchasing of shares in a company as an indirect investment. That is a purely financial investment not related to the control of the company. Bonds sold by developing-country governments and corporations to foreign buyers are also classed as portfolio investments.

(ii). Commercial-bank lending - Commercial banks involved in international finance lend to foreign governments, firms and individuals. They may do so at arm's length from bank offices in their home countries (technically international banking) or, increasingly, from branches set up abroad, often in the countries in which their borrowers reside or operate (multinational banking).

(iii). Foreign direct investment - Foreign direct investment (FDI) is an investment, usually by a multinational corporation (MNC), which involves the investor in active participation in the productive activity being financed – generally by operating the production facility.

(iv). Migrants' remittances - The growth of migration and the counter-flow of remittances have been greatly facilitated by the interaction of several aspects of globalization. Improvements in the geographical coverage and reliability of international money transfer arrangements facilitate the process of regularly remitting funds between countries.

(v). Foreign aid - Official development assistance (foreign aid) is a significant component of financial flows to developing countries. Different international countries in the world give aid to assist the less developing ones to improve their economy.

(vi). Trade in goods and commercial services - Trade in goods and commercial services gives rise to flows of current-account expenditures (on imports) and receipts (from exports). The balance of trade may be an important element in the overall net cash flow position of a developing country.

Answers to SAEs 2

1). Deregulation is the removal of controls which affect international flows of capital directly through explicit administrative measures, or indirectly through market-based measures.

2). The direct measures of deregulation include: specific limits on the value of capital transactions, requirements that permission is granted by the authorities for capital transactions (usually above a certain amount), limits on the importing or exporting of currency and gold, rules governing the operation of cross-border bank accounts, regulations affecting the use or surrender of foreign exchange earned by exporters, controls on cross-border transactions in bonds, equities and other securities, restrictions on the granting of credit to non-residents, controls on the financial activities of incoming MNCs, controls on expatriate transactions in real estate, and prudential regulation of financial institutions.

3). The market-based measures of deregulation include the use of multiple exchange rates – with different rates for different uses of foreign exchange - and taxes on foreign-exchange transactions. A large part of the deregulation of international financial markets involves the winding down of these regulatory measures.

Answers to SAEs 3

1). The potential benefits of financial flows to an economy are:

(i). Increased investment in developing countries*:* Increased overall investment (worldwide) should result from the broadening and deepening of the international capital base over which risks are spread. This effect, which is logically distinct from the reorientation of funds mentioned above should further augment capital stocks and growth potential in developing countries.

(ii). Upgrading financial systems*:* Increasing inflows of funds of different kinds into developing countries may generate collateral benefits by helping to develop the financial systems.

(iii). Reduction in instability of production and associated macroeconomic aggregates*:* The impact of globalization, working through increased inward flows of portfolio investment, commercial bank lending, and FDI, can improve stability of output, employment and incomes in some developing countries – especially countries at a relatively early stage of development – by broadening the production base.

2). The potential costs of international financial flows to the Nigerian economy include:

(i). Capital flight: may encourage capital flight, as nervous owners of capital make use of the opportunity to move their funds abroad to earn higher returns, or simply to shift these funds to what they perceive to be more secure locations. Such manoeuvres narrow the resource base of the economy.

(ii). Volatile inflows of capital: If flows of capital funds fluctuate widely from year to year, it gives rise to unpredictable variations in levels of investment, employment, incomes and budget revenues, and problems may be created for both individual firms and workers and macroeconomic stabilization.

(iii). Financial crises/panics*:* Financial deregulation has also been identified as a contributory cause of financial crises in developing countries, being triggered by the volatile behaviour of certain financial flows. The core element of many financial crises is likely to be the sudden, large-scale withdrawal or liquidation of foreign-owned funds and financial assets - made easier by deregulation.

Answers to SAEs 4

1). Financial globalization encourages improved performance by the domestic financial sector in developing countries in the following ways:

Foreign banks now find it easier to set up operations expected to yield the following benefits, in developing countries: There is now easier access to overseas international financial markets and hence enhanced inflows of funds at interest rates below those formerly prevailing domestically; The regulatory and supervisory frameworks used by the incoming banks are very likely to be superior to those used by domestic banks and will probably be emulated by the latter (to appear equally sound commercially to prospective customers); The introduction of new financial instruments and technologies and increased competition will improve the quality and range of financial services offered to customers, probably at a reduced cost; Foreign banks can provide an in-country home for funds when and if there are concerns about the solvency of domestic banks, so these funds do not have to be withdrawn from the local banking system altogether.

2). Financial globalization encourages improvement in macroeconomic policies: - Capital account liberalization makes a country more vulnerable to sudden shifts in global investor sentiment, it can serve as a signal of commitment to better macroeconomic policies. Thus, the opportunities offered by financial globalization may encourage governments of developing countries to make their economies more investor-friendly by strengthening their policies on inflation, moving towards a freer foreign-exchange market, and avoiding capricious changes in fiscal policy.

Module 4: Poverty, Equity and Well-being

The international community has a long history of concern for poverty, inequality and well-being because more than a billion people live on less than one dollar per day. Hence, this module is dedicated to discussing issues on poverty, measurement of poverty and interventions targeted at reducing the level of poverty and improving well-being. The specific unit contents are as follows:

Unit 1 **Definition and Conceptualization of Poverty**

Unit 2 **Measurement of Equality of Distribution**

Unit 3 **Measurement and Assessment of Poverty**

Unit 4 **Growth-Targeted Versus Poverty-Targeted Interventions**

Unit 1 Definition and Conceptualization of Poverty

Unit Structure

1.1. Introduction
1.2. Learning Outcomes
1.3. Meaning and Views of Poverty
1.4. Absolute and Relative Poverty Lines
1.5. The Human Development Index
1.6. Global Multidimensional Poverty Index (MPI)
1.7. Summary
1.8. References/Further Readings/Web Resources
1.9. Possible Answers to Self-Assessment Exercises (SAEs) with Content

1.1 Introduction

Who can tell me the meaning of Poverty? To many of you, poverty is when someone is poor and cannot feed himself or his family. You may be right but the explanation of poverty is far more than that, so let us now define the meaning of poverty. Poverty is general scarcity or the state of one who lacks a certain amount of material possessions or money. It is a multifaceted concept, which includes social, economic, and political elements. Absolute poverty or destitution refers to the lack of means necessary to meet basic needs such as food, clothing and shelter. Absolute poverty is meant to be about the same independent of location. Relative poverty occurs when people do not enjoy a certain minimum level of living standards as compared to the rest of society and so would vary from country to country, sometimes within the same country.

However, much effective action of a human-development type against extreme deprivation is possible even in countries of low income. In the face of more foreseeable emergencies such as crop failures, the suffering may be effectively mitigated, and rises in death rates prevented by appropriate measures adequately prepared that draw on state, market, and civil society. But, progressive improvement in living standards for the majority of the population from a low base, requires continuing economic growth generally and substantially faster than population growth. Where there is a capacity for fast growth, combining it with progressive equalization is possible, and ideally. It can be accompanied and boosted by continuing human-development action, with safety nets for those who would otherwise lack minimally acceptable means of support. In this unit, we answer the following questions: What do we mean by poverty? What are its signs? How do we measure it? How extensive and serious is it?

1.2 Learning Outcomes

By the end of this unit, you will be able to:

- Define and enumerate the meaning of poverty
- Describe absolute and relative poverty
- Explain the human development index (HDI)
- Write on the Global Multidimensional Poverty Index

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1.3 Meaning and Views of Poverty

1.3.1. Meaning of Poverty

By poverty we understand the inability, through the circumstances of a person's life, to satisfy essential material needs for what can be called well-being or happiness. Poverty can be explained as deprivation of material well-being. World Bank (2000 as cited in Metu & Kalu, 2019) explained poverty as the lack of necessary materials well-being-especially food, housing, land, and other assets. From this definition, we can deduce that poverty is hunger, not being able to go to school, lack of shelter and fear for the future because one does not have a job to provide the necessities of life. Satisfying material needs can never be a sufficient condition for happiness, but some degree of material satisfaction must be virtually a necessary condition for most of us. Most people would judge that there are forms and degrees of material deprivation for themselves or forms and degrees of material deprivation for anyone that would make well-being impossible. However, that definition – failure through circumstances to satisfy the necessary material conditions for well-being – immediately leads us to the important distinction between absolute and relative poverty.

1.3.2. Views of Poverty

The basic needs and capabilities approach to development (Stewart, 2006; Clark, 2006b) can be taken to imply corresponding emphases in the understanding of poverty. The basic – needs discussion arose in the 1970s as a human-centred reaction against the preoccupation with aggregate economic growth. The capabilities approach, stemming from Amartya Sen in several publications since the early 1980s (e.g., 2005), attempts a further degree of humanization by emphasizing needs that go beyond physical and emotional comfort to include capacities for purposive activity.

A basic-needs approach to poverty, then, is one under which policy at any time or place sets minimum absolute standards of (mainly material) need in several measurable dimensions. Listing them implies that it is a vital responsibility for each political community, and the world, to aim to meet them. Yet the operational target does not have to be static. Making the goals realistic often requires them to be reached gradually. This is the view behind the Millennium Development Goals, which have set the world intermediate targets to be met by certain dates.

We can also see poverty as a lack of basic capacities or capabilities. This is Sen's view of the deficiency to which development is the answer. The poor are those deprived not only in what they receive but also in what they can achieve, with the one lack closely related to the other. Due to the close connection between material deprivation and the lack of capabilities, it has been argued that the basic needs and capability approaches can be defined to be mutually consistent.

Human development as the term is used by the United Nations Development Program (UNDP), covers progress or attainment in any aspects of human material welfare but a very broad sense of 'material' – including education, for example. The agency's Human Development Index (HDI) for individual countries is a composite of average spending power with ratings on some concrete basic-welfare indicators. The HDI can be no more than a rough pointer which, by including a few health and education statistics, at least gives a more human-centred and poor-oriented assessment of a country's achievement in material well-being than average income alone. Its use of country indicators in constructing the index has to be limited in practice to those that are almost universally available. Insofar as it includes literacy rates and school-enrolment ratios, as well as life expectancy, it can be regarded as not entirely neglecting capabilities in its assessment of basic needs. The UNDP has a corresponding Human Poverty Index (HPI).

Self-Assessment Exercises 1

1. Discuss briefly the definitions of Poverty
2. Discuss the basic need approach to understanding the term poverty

1.4. Absolute and Relative Poverty Lines

The general definition of poverty can be categorized as either relative or absolute and it can be classified as permanent or transient. Poverty is generally defined in an absolute sense (Metu & Kalu, 2019). People's sense of well-being is inevitably conditioned by the conditions that they see around them, and what they have come to expect. This is a matter of common experience and is confirmed by more systematic evidence from questionnaires. A family may regard as a luxury a diet confined to a few vegetables and as much of a staple cereal as its members can eat, and having plenty of clean water from a nearby public standpipe; while another family, in a much richer society, may see this as misery. Absolute expressions for poverty set lower limits – absolute levels of disposable income and minimal provision of social goods such as disease prevention and physical security – below which no one anywhere should be allowed to fall. On the other hand, the authorities in a particular country, concerned with relevantly identifying poverty for their people, may specify requirements, relative to the country's prevailing standards of living. The absence of which they believe would preclude a sense of minimal well-being for their citizens. For example, an income per person in each household is not less than half the median for the country.

Poverty lines are set up as signposts of what ought to be. The bearing of various experiences on happiness or well-being may be a matter for empirical investigation, but where exactly a poverty line- absolute or relative- is drawn involves also a value judgment. Much of what is said below about the measurement of the extent and intensity of poverty concerning defining limits may be applied to either absolute or relative lines, but it is useful to bear in mind which of the two is being discussed in any instance. In this unit, it will be absolute lines. International concern about poverty centres inevitably on absolute limits, but how people stand concerning their own country's or community's material standards may also still be an important indicator of material limits to their wellbeing. Yet even absolute poverty, on these understandings, is in an important sense relative: it is a matter of degree. The interpretation of absolute poverty depends on what needs are regarded as essential to every human being and to what extent – food quantity and nutritional quality; access to clean water, means for sanitary disposal of waste, clinical health services and public protection against disease; access to literacy, numeracy, specialized skills, and knowledge about the world; and, in part summary or general indicator, in part supplement, some measure of overall spending-power – all matters of more or less.

So lines defining what is essential are inevitably arbitrary; and as we shall see, the standard international ones have almost inevitably been subject to change to increase their usefulness and relevance. Yet they have a necessary role in setting policy targets. To be useful the lines drawn must bear some relationship to possibilities – what social arrangements could in principle achieve – as well as to ideals.

Self-Assessment Exercise 2

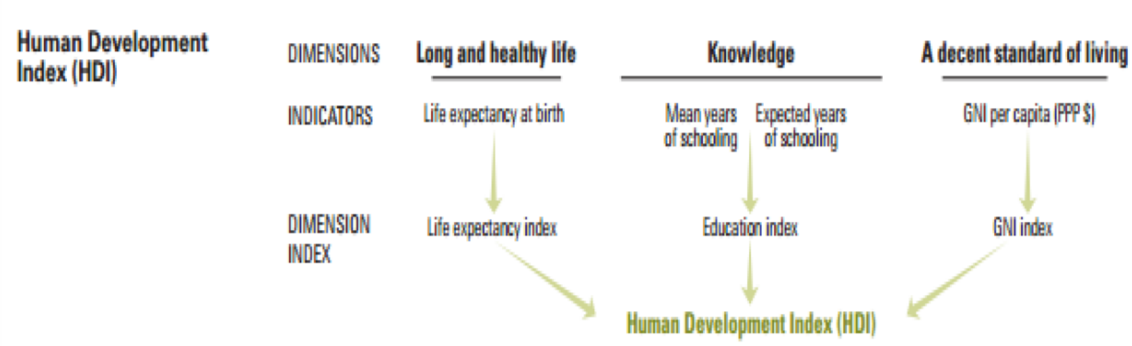
1. Describe the term absolute poverty

1.5 Human Development Index

The HDI emphasizes that people and their capabilities should be the ultimate criteria for assessing the development of a country, not economic growth alone. The HDI can also be used to question national policy choices, asking how two countries with the same level of GNI per capita can end up with different human development outcomes. These contrasts can stimulate debate about government policy priorities. The Human Development Index (HDI) is a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and having a decent standard of living. The HDI is the geometric mean of normalized indices for each of the three dimensions. Refer to Technical notes for more details.

The health dimension is assessed by life expectancy at birth, and the education dimension is measured by the mean of years of schooling for adults aged 25 years and more and expected years of schooling for children of school entering age. The standard of living dimension is measured by gross national income per capita. The HDI uses the logarithm of income, to reflect the diminishing importance of income with increasing GNI. The scores for the three HDI dimension indices are then aggregated into a composite index using the geometric mean. The HDI simplifies and captures only part of what human development entails. It does not reflect on inequalities, poverty, human security, empowerment, etc. The HDRO offers the other composite indices as a broader proxy for some of the key issues of human development, inequality, gender disparity and human poverty.

A fuller picture of a country's level of human development requires analysis of other indicators and information presented in the statistical annex of the report.



Source: Human Development Indicator (2012)

Self-Assessment Exercises 3

1. Explain the Human Development Index.
2. What are the indicators of the Human Development Index

1.6. Global Multidimensional Poverty Index (MPI)

The global MPI was developed by UNDP and the Oxford Poverty and Human Development Initiative to measure poverty by considering various deprivations experienced by people in their daily lives, including poor health, insufficient education and a low standard of living. The report examines the level and composition of multidimensional poverty across 109 countries covering 5.9 billion people and presents an ethnicity/race/caste disaggregation for 41 countries with available information. It also shows how, within a country, multidimensional poverty among different ethnic groups can vary immensely. For example, the difference in the percentage of people who are multidimensional poor across ethnic groups is more than 70% points in Nigeria.

The MPI combines the incidence and the intensity of poverty. An intra-household analysis of multidimensional poverty focused on gender is also included. Worldwide about two-thirds of multidimensionally poor people (836 million) live in households where no woman or girl completed at least six years of schooling. One-sixth of all multidimensionally poor people (215 million) live in households in which at least one boy or man has completed six or more years of schooling but no girl or woman has (UNDP, 2021). The report also finds that women and girls living in multidimensional poverty are at higher risk of intimate partner violence

Self-Assessment Exercise 4

1. Explain poverty using the multidimensional poverty index.

1.7. Summary

In this unit, we discussed the meaning of poverty, absolute and relative poverty, views of poverty and human capital development. We explained poverty as a lack of basic capacities or capabilities. Poverty has become a great issue in our world. Though many organizations have been created to find solutions for this matter nobody could not save our world completely from poverty. The most common fact that we can realize when we consider information about poverty is that poverty is mostly occurring in developing countries. What are the causes of poverty, mostly? According to economists, reasons for poverty are history, war and political instability, servicing of national debts, discrimination and social inequality and vulnerability to natural disasters. Poverty is the significant lack of money or poorness. Poverty is mainly viewed as having so little money that one cannot pay for necessities, such as food and shelter

1.8 References/Further Readings/Web Resources

Metu, A. G. & Kalu, C. U. (2019). Problems of Poverty and Inequality in Nigeria. In U. R. Ezenekwe, A. G. Metu, E. S. Nwokoye & O. L. Maduka (eds.), *Structure and Problems of the Nigerian Economy (226-251).* Awka: Fab Anieh Nig Ltd.

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Peters, P. G. (2011). *Development Economics: A broader Perspective, 4th Edition*. Ibadan Press limited.

UNDP (2021). *The 2021 Multidimensional Poverty Index*. Human Development Reports. Retrieved from: https://hdr.undp.org/en/2021-MPI

1.9 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). Poverty means the inability to satisfy essential material needs through the circumstances of a person's life. Poverty can be explained as the deprivation of material well-being. According to World Bank, poverty is the lack of necessary materials well-being-especially food, housing, land, and other assets. From this definition, we can deduce that poverty is hunger, not being able to go to school, lack of shelter and fear for the future because one does not have a job to provide the necessities of life

2). The basic-needs approach to understanding poverty, is one under which policy at any time or place sets minimum absolute standards of (mainly material) needs in several measurable dimensions. It is a vital responsibility of each political community, and the world, to aim to meet them. This is the view behind the Sustainable Development Goals with targets being met by 2030. Here, poverty is seen as a lack of basic capacities or capabilities. The poor are those deprived not only in what they receive but also in what they can achieve, with the one lack closely related to the other. Due to the close connection between material deprivation and the lack of capabilities, it has been argued that the basic needs and capability approaches can be defined to be mutually consistent.

Answers to SAEs 2

2). Poverty is generally defined in an absolute term. Absolute expressions for poverty set lower limits below which no one anywhere should be allowed to fall. People's sense of well-being is inevitably conditioned by the conditions that they see around them, and what they have come to expect. For instance, a family may regard as a luxury a diet confined to a few vegetables and as much of a staple cereal as its members can eat, while another family, in a much richer society, may see this as misery.

Answers to SAEs 3

1). The Human Development Index (HDI) emphasizes that people and their capabilities should be the ultimate criteria for assessing the development of a country, not economic growth alone. The HDI can also be used to question national policy choices, asking how two countries with the same level of GNI per capita can end up with different human development outcomes. These contrasts can stimulate debate about government policy priorities. The Human Development Index (HDI) is a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and having a decent standard of living. The HDI is the geometric mean of normalized indices for each of the three dimensions.

2). The key indicators of the HDI are: (i). Achieving a long and healthy life, (ii). Being knowledgeable and (iii). Having a decent standard of living.

Answers to SAEs 4

1). The global Multidimensional Poverty Index was developed by UNDP to measure poverty by considering various deprivations experienced by people in their daily lives. These deprivation include poor health, insufficient education and a low standard of living. The report shows how, within a country, multidimensional poverty among different ethnic groups can vary immensely. For example, the difference in the percentage of people who are multidimensional poor across ethnic groups is more than 70% points in Nigeria. The MPI combines the incidence and the intensity of poverty. An intra-household analysis of multidimensional poverty focused on gender is also included in the report.

UNIT 2 MEASUREMENT OF EQUALITY OF DISTRIBUTION

Unit Structure

2.1. Introduction
2.2. Learning Outcomes
2.3. Lorenz Curve and Gini Coefficient
2.4. Other Measures of Inequality
2.5. Summary
2.6. References/Further Readings
2.7. Possible Answers to Self-Assessment Exercises (SAEs) within Content

2.1 Introduction

One of the central points of contention in literature is how to measure income inequality itself. The impetus behind the debate is Kawachi and Kennedy's influential US study, which compared the behaviour of six different measures of income inequality: the Gini coefficient, the decile ratio, the proportion of income earned by the poorest 50%, 60% and 70% of households, the Robin Hood index, the Atkinson index and Theil's entropy measure. Their analysis indicated that the measures behaved very similarly and were highly correlated, with Pearson correlations ranging from 0.86 to 0.99. In this unit, we will discuss the different methods of measuring inequality.

2.2 Learning Outcomes

By the end of this unit, you will be able to:

- Define the meaning of the Lorenz Curve and Gini Coefficient
- Describe the Quintile Ratio and other measures of inequality

.

2.3 Lorenz Curve and Gini Coefficient

One method of measuring inequality is the Lorenz curve and its derivative, the Gini coefficient. The Lorenz curve is a curve showing visually the distribution of one variable (here income) across a population. It is plotted from an origin, O in Figure 3.1, at the intersection of two axes; the horizontal one measuring proportions of the total population, and the vertical representing proportions of total income. Successive points on the curve, starting from O, are found by plotting the poorest say 1% of the population, x_1, against the proportion, y_2, of total income that that poorest 1% receives; then say the population share, x_2, of the poorest 2%, against the share of income it receives, y_2; and so on until the point is reached at 100% on the x-axis and 100% on the y axis, point Z in Figure 3.1. The farther the Lorenz curve deviates from the diagonal of the diagram, the more unequal the distribution is.

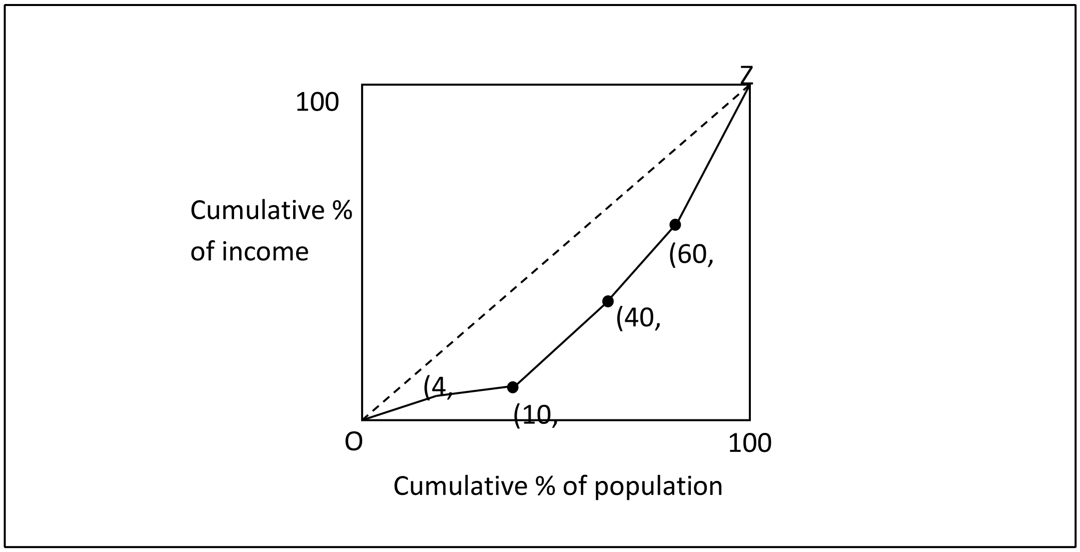

Figure 3.1 Lorenz Curve
Source: Obadan (2013)

The Gini coefficient is a numerical measure of inequality. It is given by the ratio of (i) the area between the Lorenz curve and the diagonal to (ii) the total triangular area below and to the right of the diagonal. However, there are different ways of being unequal. Degrees of inequality cannot be ranked entirely satisfactorily on a single scale. If two countries, A and B have the same average income and their Lorenz curves imply the same Gini coefficient for both, A's curve may be closer to the diagonal than B's in the lower left of the diagram but further away in the middle and upper right. The poor in country A will then be better off than those in B, but a segment of the middle earners, above a certain low level of income but below the very richest, will be poorer than the corresponding people in B. There is no compelling answer to the question of which of the two countries is the more unequal. All of this can be taken to illustrate the point that there is no ideal way of measuring inequality.

Self-Assessment Exercises 1

1. What is a Lorenz Curve?
2. Write short note on Gini coefficient

2.4. Measures of Inequality

2.4.1 Richest-to-Poorest-Quintile Ratio

The second common way of expressing the degree of inequality of income in a country is to compare the share of its total income earned by say the top fifth ('quintile') or tenth ('decile') of income earners' income with the share going to the bottom fifth or tenth, for example by showing the ratio between the shares of the top fifth to the bottom fifth. The order of inequality rates on one of these measures will not necessarily be the same as the order of Gini coefficients.

2.4.2 Other Measures of Inequality

There are other indicators of inequality, some of which are directed at making assessments of material-welfare improvement or achievement that take into account in a single figure both the increase or attainment of income and how it is distributed. The Atkinson (1970). The same Gini Coefficient in both countries, but Country A is more equal at the lower and of the distribution (lowest 40% of people) index, directed only at comparisons of inequality, depends for its value in any case on an explicit judgment (arguably one of value): in effect on how the marginal utility of income (the value that is put on a marginal unit of income) should be taken as diminishing as income increases (Fields, 1980).

The approach of Ahluwalia and Chenery (Chenery et al., 1974) to taking account of distribution in evaluating income growth is to apply weighting factors to the aggregate incomes of the various quintiles of income earners. The point of doing this rather than simply citing an aggregate rate of growth is seen as follows. If the top quintile earns ten times as much as the bottom quintile, giving a rate of aggregate growth of income of the whole population in the usual way weights any given proportional rise in income ten

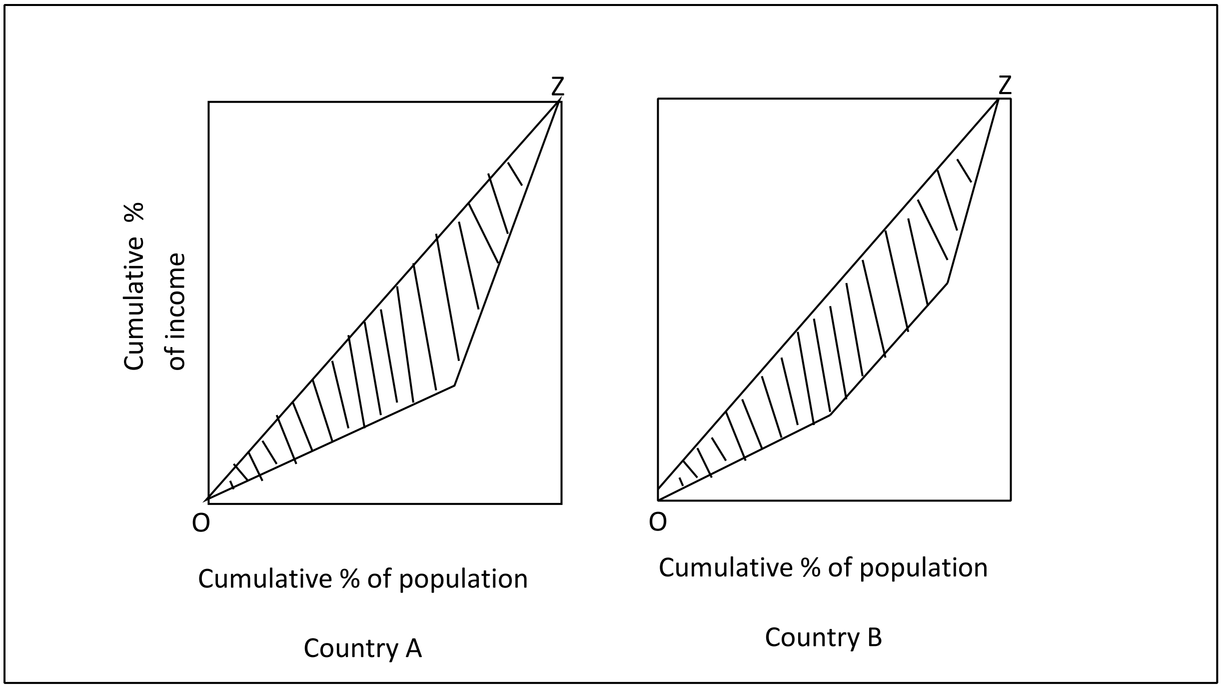

Figure 3.2: Gini coefficient for two countries A and B
Source: Obadan, (2013)

times as high if it occurs in the top quintile as if it occurs to the same number of people who form the bottom quintile. One way of distribution-weighting of growth would be to give the same weight to the income of each quintile. This could be called equalizing weighting. A ‘poverty-weighting’ could give an even higher relative importance to the incomes of the poorer ranks. Again fixing the weighting would be a matter of explicit value judgment.

Self-Assessment Exercise 2

1. Define the term “Quintile Ratio”.

2.5 Summary

In this unit, we discussed that income inequality (metrics) or income distribution metrics are used by social scientists to measure the distribution of income, and economic inequality among the participants in a particular economy or the world in general. While different theories may try to explain how income inequality comes about, income inequality metrics simply provide a system of measurement used to determine the dispersion of incomes. The concept of inequality is distinct from poverty and fairness. The Gini coefficient has been the most popular method for operationalizing income inequality. However, several alternative methods exist, and they offer researchers the means to develop a more nuanced understanding of the distribution of income. Income inequality measures offer the ability to examine the effects of inequalities in different areas of the income spectrum, enabling more meaningful quantitative assessments of qualitatively different inequalities.

2.6 References/Further Readings/Web Resources

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2.7 Possible Answers to SAEs

These are the possible answers to the SAEs within the content.

Answers to SAEs 1

1). The Lorenz Curve is one method of measuring inequality. The Lorenz curve is a curve showing visually the distribution of income across a population. It is plotted from an origin, O at the intersection of two axes; the horizontal one measuring proportions of the total population, and the vertical representing proportions of total income. The farther the Lorenz curve deviates from the diagonal of the diagram, the more unequal the distribution is.

2). The Gini coefficient also known as the Gini index measures income distribution across a population. It helps to measure income inequality. In other words, the Gini coefficient is a statistical measure of economic inequality in a population.

Answers to SAEs 2

1). Quintile ratio is calculated as the ratio of the total income received by the 20% of the population. It is the ratio of the total income received by the 20% of the population with the highest income (top quintile) to that received by the 20% of the population with the lowest income (the bottom quintile).

UNIT 3 MEASUREMENT AND ASSESSMENT OF POVERTY

Unit Structure

3.1. Introduction

3.2. Learning Outcomes

3.2. Measures of Income Poverty

3.3. Poverty, Inequality, National-Income Level and Growth Relationship

3.4. Bearing of Poverty on Capacity for Growth: Are there Vicious Circles?

3.5. Implications of the Functional Distribution of Income on Poverty

3.6. Summary

3.7. References/Further Readings/Web Resources

3.8. Possible Answers to Self-Assessment Exercises (SAEs) with Content

3.1 Introduction

Economists have differed as to whether poverty should be measured in an absolute sense, defining poverty as people falling below some fixed minimum income or consumption level; or whether it should be defined in relative terms so that poverty means the inability to afford what average people have. If an absolute measure is accepted, it is at least conceivable to have everybody lifted above the poverty line whereas if poverty is measured in a relative sense, some people will at least fall below the so-called poverty line, which means the poor will always be with us.

3.2 Learning Outcomes

By the end of this unit, you will be able to:

- Explain different income poverty measures
- Describe the effect of poverty on the capacity for growth
- Illustrate the fundamentals of poverty and inequality

3.3 Measures of Income Poverty

The poverty line is a basic measure and an instrument for identifying and measuring income poverty. It is defined as an arbitrary income measure, usually expressed in constant dollars (e.g. $1 per day), used as a basis for estimating the proportion of a country's population that exists at the bare level of subsistence. Based on household income or consumption, poverty lines quantify absolute poverty in monetary terms and characterize people in terms of their monetary income or consumption, particularly of food. Thus, a poverty line is just a cut-off line (or threshold) used to distinguish between "poor" and "non-poor" households.

Setting a poverty line permits the calculation of the following poverty indicators:

(i) Poverty rate or incidence of poverty: An estimate of the percentage of people living below the poverty line.

(ii) Depth of poverty or poverty gap: The average distance below the poverty line, expressed as a percentage of that line. It is also called the poverty gap as it shows the average distance of the poor from the poverty line.

iii) The severity of poverty: A weighted average of the squared distance below the poverty line, expressed as a percentage of that line. The weights are usually given by each gap. Since the weights increase with poverty, this measure is sensitive to inequalities among the poor.

One final measure of poverty, credited to the United Nations Development Programme (UNDP) in its 1997 Human Development Report, was introduced against the background of dissatisfaction with the dollar–a–day World Bank income measures. As articulated in the Report: "Poverty has many faces, it is much more than low income. It also reflects poor health and education, deprivation in knowledge and communication, inability to exercise human and political rights and absence of dignity confidence and self-respect" [UNDP, Human Development Report, 1997]. Based on this, the UNDP developed a measure of human poverty – that is, the human poverty index (HPI). The HPI constructed is a multidimensional measure of poverty, incorporating three key deprivations in respect of survival, knowledge, and economic provisions. The deprivation in longevity (survival) is measured as the percentage of people not expected to survive to age 40. The deprivation in knowledge is measured by the percentage of adults who are illiterate, while the third deprivation, economic provisions, relates to a decent living standard. It is represented by a composite of three variables, namely the percentage of people without access to safe water, the percentage of people without access to health services, and the percentage of malnourished children under five.

The HPI measure provides a quantitative and more comprehensive poverty indicator when compared to the income poverty index. Income poverty, no doubt, needs to be measured, but income alone is too narrow a measure. Thus, HPI developed by UNDP, provides a more robust and broad measure of poverty indicator; summarizing the extent of poverty along several dimensions. The index makes possible a ranking concerning a combination of basic deprivations and also serves as a useful complement to other measures of poverty and human deprivation - including income poverty. One shortcoming of HPI, however, is that it is somehow aggregative as it is not possible to associate poverty incidence with a specific group of people or a number of people.

There are two basic approaches to the measurement of the poverty of a community or region. It can be measured by the prevalence and extent of failure on the part of individuals or households to reach certain income or expenditure levels. Secondly, it can be measured by the extent of the collective achievement in satisfying certain concrete basic needs or attaining other desirable welfare goals.

3.3.1. Income poverty as indicated by poverty headcounts and gaps

The usual summary way of measuring the extent and depth of income-poverty for purposes of comparisons between countries or over time is by the use of poverty lines. Cross-country comparisons have to be made by some standard that is absolute in the sense of being the same for all the countries compared. The World Bank uses two lines for what can be called poverty and extreme poverty respectively; where household income per person is below US$2 a day and US$1 a day in PPP (purchasing power parity). This is equivalent to all in 1985 prices so the $1 a day was PPP $1.08 a day in 1993 and $1.45 a day in 2005. (The PPP-$1-a-day standard denotes not what a US dollar can buy in the country concerned, but as near as possible to what a US dollar would buy in the US in 1985, which for daily sustenance is not a lot: not much more, at most, than a euro, a day would buy in Germany or 60 pence a day in Britain in the early 2000s.) An alternative, which avoids the problem of comparable cash valuation but has other limitations would be to express the bounding lines as food calories, instead of US dollars, per day.

The compilers of the World Bank's poverty statistics (WDR, 2007) recognize horrendous difficulties in making the poverty figures accurate and comparable across countries. Besides income or output measures in local currencies (which have the usual difficulties such as valuation of non-marketed goods) they depend upon surveys of prices in each country to work out equivalents in PPP dollars. Several price surveys for this purpose have been conducted since 1970. The eighth of these, for 2005, had the biggest range to date, of 146 economies (101 of them low – or middle-income countries) covering over 95 per cent of the world's people (World Bank, WDI, 2008). Despite the great effort put into making the published figures internationally comparable, they have to be taken as approximate at best.

The extent of extreme poverty in a country is in this way very roughly indicated by the number of its population meeting the arbitrary test of living in households with less than one PPP dollar a day per member, a 'headcount index'. What might be called the weight or depth of extreme poverty can correspondingly be measured by the amount (in, say, PPP dollars) by which the aggregate incomes of people in this category fall short of a PPP dollar a day per person. This can be expressed as (1) simply an aggregate amount of annual income (the total poverty gap, TPG); or as (2) the average gap per person across the total population (the average poverty gap, APG); or as (3) the proportion that the TPC bears to total possible income below the poverty line (that is to the poverty-line income per person multiplied by the total number of the population], that proportion being the normalized poverty gap, NPC.

The TPG is the amount of extra income that would have to be distributed to those below the poverty line concerned to bring all their incomes up to that line. The percentage 'gap', as presented by the World Bank (e.g., 2006), is the NPG. If all the extremely poor are just below the extreme poverty line, the NPG percentage will be low. If they are all living next to nothing, it will be close to the percentage of people living in extreme poverty.

We should expect the incidence and depth of poverty to be determined by a combination of per capita income and inequality of distribution. In principle, if we had enough measures of distribution capturing inequality from various angles, an appropriate selection of them, together with average income, might predict reasonably closely a country's rating on each of the various poverty measures, but that is hypothetical. With the limited inequality indexes, we have, let alone the much more limited selection given here, that is a long way from being the case. There seem in fact to be loose relationships of the form expected, but some puzzles.

Self-Assessment Exercises 1

1. Discuss the measurement of income Poverty.
2. Setting a poverty line permits the calculation of the some poverty indicators. Identify these indicators.

3.4. Poverty, Inequality, National-Income Level and Growth

Whether there is any relationship consistent enough to be meaningful between income level and degree of inequality – and, if there is, what it means for policy – are contentious questions. Simon Kuznets (1955, 1963) concluded from the cross-sectional comparison that inequality, as measured by the proportional shares of various income-quintiles, tended first to increase as one moved from lower to higher per capita incomes and then beyond a certain income level to fall. Several subsequent studies using various measures of inequality found similar results. This pattern could be represented by an inverted U-shaped curve, the Kuznets curve, with inequality on the vertical axis and per capita income on the horizontal.

Fields (1980) reviewed a number of these studies concerning a threefold division of types of economic growth in an economy supposed to be 'dualistic' (a traditional and a modern sector). These types were traditional-sector-enrichment growth, modern-sector-enrichment growth, and modern-sector-enlargement growth. The third of these involved the movement of people and activity into the modern sector (often but not necessarily urban) from the traditional. It was assumed that the modern sector would have higher labour productivity and higher labour incomes than the traditional and that the poor would be concentrated disproportionately in the traditional sector. All three types of growth would by definition raise overall income, but in Field's (1980) analysis they would have different impacts on relative inequality and absolute poverty. The first, raising income differentially in the poorer sector, would tend to reduce absolute poverty and relative inequality. The second would increase relative inequality and have little effect on absolute poverty. The third would reduce absolute poverty but might either raise or lower relative inequality, depending on the balance between different effects. On the supposition that growth was predominantly of modern-sector-enlargement type, Fields provided a demonstration that relative inequality, as judged in various ways, would indeed first rise and then decline as this growth proceeded so that the inverted U-curve could in those terms be explained.

However, what does the inverted U-curve, if it existed, mean for policy? One interpretation was that rising inequality had to be accepted in the 'early' stages of growth, and that interfering with distribution in the direction of equalization would tend to inhibit growth. This view could be attacked on various grounds, several of them used by Fields. One was that the observed relationship between income level and distribution was not a close one (as can be seen, for example, by casual inspection of the table in Chenery et al., 1974). Several other factors showed relationships with income distribution. A second was that the association was not necessarily causal in the direction the argument would imply.

Fields also argued that looking at relative inequality was concentrating on the wrong indicator from a welfare viewpoint. What ought to be of interest was absolute poverty. On that score growth, unless confined to modern-sector enrichment (in which case poverty was unaffected), would move in the right direction, so that between absolute poverty reduction and overall growth there was no conflict. On the other hand, falling relative inequality might, as possible for India in the 1960s, be consistent with an increasing headcount of extreme absolute poverty.

A further argument more specifically against the view that growth and equalization policies were mutually inconsistent at certain levels of income, was given by Fei, Ranis, and Kuo (1979). They argued that one contrary case was enough to falsify the generalization and that Taiwan from some time in the late 1950s provided a striking example of continued rapid growth with simultaneously falling inequality indicators. Tables (Fei et al., 1979; Fields, 1980) show mean household income in Taiwan grew at 3.3 per cent a year between 1953 and 1964 but thereafter at 8.2% a year until 1972; while the income ratio of the top to the bottom tenth fell from 30.4 in 1953 to 8.6 in 1964 and 6.8 in 1972; and the Gini fell from 0.558 in 1953 to 0.328 in 1964 and 0.301 in 1972. Similarly, the scatter-diagram in Figure 10.3 on p. 263 shows Taiwan's total GNP over eight years growing at around 7 per cent a year between 1953 and 1961, while the income of its poorest 40 per cent grew at around 12 per cent a year.

So, though there is quite a lot of cross-sectional evidence of some tendency for inequality to rise and then fall as mean income rises, there is no reason whatever to think that equalizing policies at any stage of growth ipso facto limit growth, or (a different question) that growth and the reduction of absolute poverty must be, or are likely to be competing objectives.

The practical bearing of Fields' supposition that per capita growth will always tend to reduce poverty unless it is of the modem-sector-enrichment type may perhaps be seen in the following way. An increase in income that is registered simply because of a natural resource bonanza with little direct (first-round) positive employment effect will do little to draw workers into the modern sector and to that extent will constitute modern-sector enrichment rather than modern-sector enlargement and may have little or no positive effect in poverty reduction. Any increase in employment in the resource industry itself is counterbalanced by a 'Dutch-disease' effect, which in itself will reduce modern-sector employment. However, if the process can be turned into modern-sector enlargement through the spending by the recipient (the state itself, at least in part) of the resource rents, especially on projects (such as transport and energy infrastructure) that will be geared to producing growth of other kinds - rather than dispersing the resource rents abroad as personal plunder or hoarding them as reserves -the effect on poverty-reduction may well be positive. Another possible example of the bearing on the poverty of whether growth is concentrated on enrichment or enlargement of the modern sector is provided by the comparison of recent fast growth between India and China.

India's spurt in exports has depended heavily on services of back-office type, requiring language, mathematical, and programming skills, but not, in its first-round effects, demanding much-unskilled labour. Manufactured exports of comparable value-added, more important relatively in China, have a large appetite for low-skilled workers, drawing surplus labour from the traditional sector, and on the whole, increasing the incomes both of those who move and of those who remain. By the late 1990s, China had begun to show significantly rising wages in both towns and villages, suggesting that it had moved out of the 'Lewis' stage.

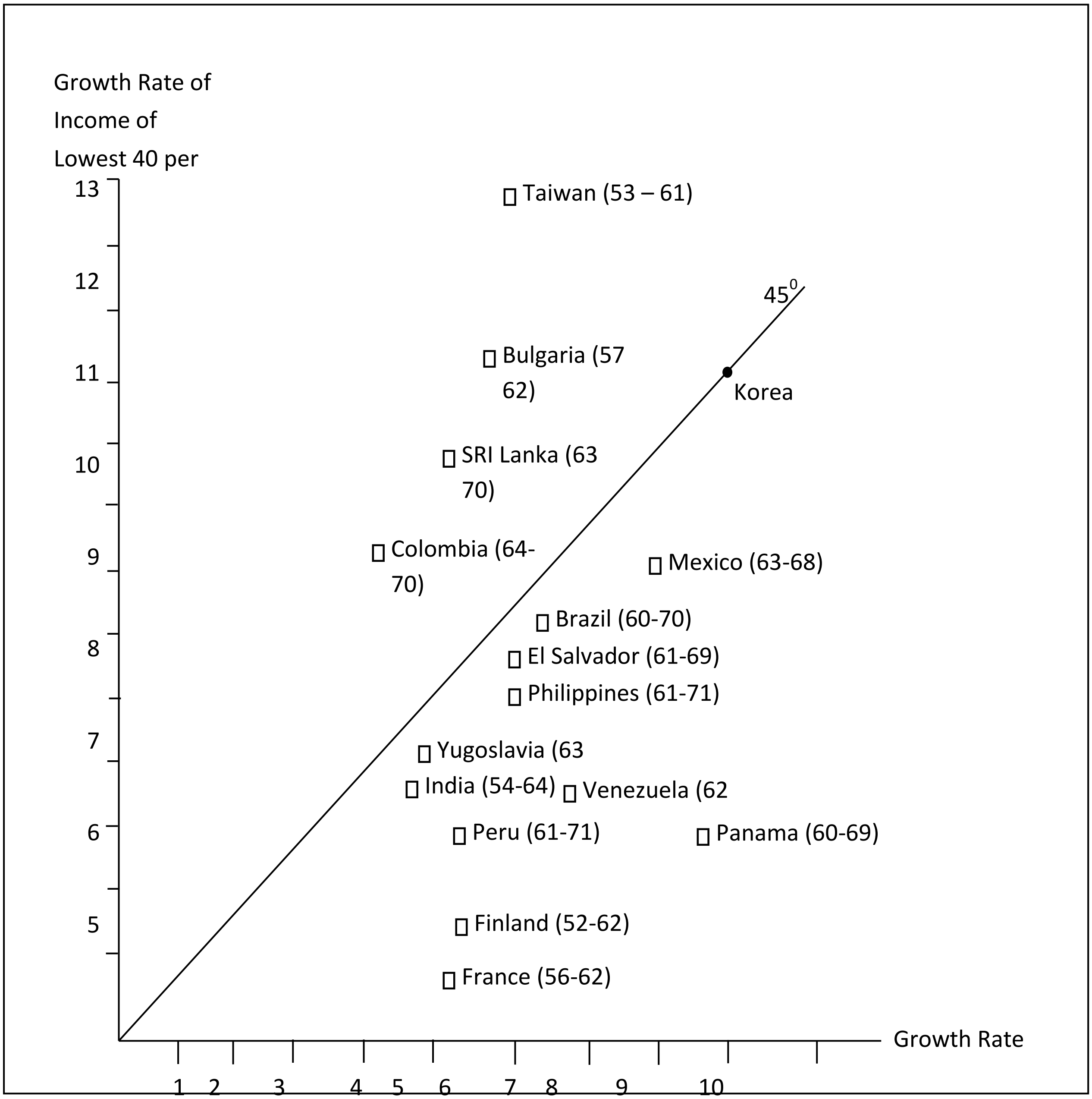

Figure 4: Growth rate of GNP and of income of lowest 40% (countries and periods indicated)
Source: Chenery, *et al*. (1974:14). Reproduced by permission

Self-Assessment Exercise 2

Discuss the bearing of growth and per capita income level on equality and poverty using Kuznet's curve

3.5. Bearing of Poverty on Capacity for Growth: Are There Vicious Circles?

A further question is whether there are low-level 'traps' entailed by low, or at least falling, per capita income nationally or locally, or by absolute poverty beyond a certain extent or intensity, that themselves inhibit economic growth. A 'vicious circle of poverty model was common in early development-economics thinking. This generally explained the trap by low or zero rates of net saving (and hence of investment and economic growth) that could be expected with incomes below a certain level. It was one argument for the injection of substantial funds from abroad to produce a sufficient once-for-all spurt of growth to turn the vicious circle into a virtuous one.

Subsequent experience has thrown doubt on whether saving rates at the relevant low levels of income are necessarily low enough to cause this effect. Microfinance has been held to demonstrate that, with appropriate institutions, even very poor people may consistently save to invest. However, new forms of vicious-circle argument have recently been put by Jeffrey Sachs and Paul Collier, with diagnoses that at least overlap with one another, though the policy implications they draw are not precisely the same. Sachs's argument is applied at both the national level (Bolivia in its hyperinflation at the time of the 1980s debt crisis and the collapse of tin prices, and contrasting stories of the treatments of Poland and Russia after the Communist collapse) and local level. It means that when a country or local community has fallen into a sufficiently serious crisis, once-for-all help from outside may be necessary to restore it or to stop further deterioration, and failure to provide the help can lead to bad political repercussions locally and even on occasion for the rest of the world. There will often be critical blockages to growth that need to be identified. Removing them within a locality may involve directly humanitarian action such as measures to increase food production and protect against disease. In those circumstances, such assistance with basic needs will itself be a path to economic growth.

Concentrating attention on those poor countries, mainly in Africa, that have stagnant or falling mean income, Collier also explains their plight by expounding various 'traps' that interact negatively with unchanging or increasing poverty and with each other. Those traps most obviously aggravated by poverty and also contributing to it are what he calls the 'conflict trap' and bad government. The implication is that, without some route to significant growth, conditions are likely to become cumulatively worse. Financial or technical aid from abroad may sometimes help but is not always the only or most relevant escape hatch. Natural-resource bonanzas may be more problems than a solution because of Dutch disease effects and because of their propensity to encourage bad government and civil conflict. Sometimes military intervention, possibly in the shape of UN peacekeeping forces, may represent an effective, and most efficient, way out (Collier, Chauvet & Hegre, 2008).

Self-Assessment Exercise 3

1. Describe the vicious cycle of Poverty.

3.6. Implications of the Functional Distribution of Income

The functional distribution of income refers to income distribution among factors of production (generally before taxes and transfers). The factors of production are commonly simplified for analytical purposes into three or four: land, labour, and capital, with human capital commonly a fourth. In a market economy returns per unit to the various factors will be determined (other things being equal) by their relative scarcity. The larger the unskilled labour force is about endowments of the other factors, the lower the unskilled wage will tend to be. The 'unskilled wage' in this sense covers not only the rates of pay of those whose only source of income is unskilled wage-work. It includes the part of the income of anyone – self-employed farm family, small-business operator, and independent service worker – that is attributable to unskilled work. Income from unskilled or low-skilled labour is liable to play a large part in the incomes of the very poor.

In the logic of the functional distribution of income, policy to increase the gross (i.e., before-tax-and-transfer) income of the very poor can be expected to be largely dependent on either transferring to the poor possession of larger shares of the other factors (land, capital and skills) or increasing the economy's stocks of the other factors about that of unskilled labour. In economies that fit the general description of the Lewis model, the story is complicated by the existence of 'unlimited supplies of labour in the traditional sector that is of labour surplus to the needs of existing production. Increasing the stocks of other factors will then not render unskilled labour 'scarce' (and so raise its return per unit) until the surplus labour has been drawn into the modern sector.

As a result of taxes and transfers, the final distribution of disposable income in the non-state sector may differ from that determined by relative factor scarcity. The pattern of taxation - how it bears differentially on rich and poor – can make a difference. Indirect taxes are likely to bear more severely on the poor than income taxes, which can be tempered to the ability to pay and are likely, even if only for administrative reasons, to exempt the very poor. However, deliberate redistribution of cash income through transfers has been thought difficult to manage fairly and efficiently in these countries, and until recently has rarely been tried to any serious extent. (How it can be attempted to a limited degree is discussed below under 'Social safety nets).

Regulating wage levels to increase them is at best questionable. If it succeeded in raising the level of the wages paid, this would be quite likely to reduce wage-employment in the 'formal' (regulated) sector unless (a) wages had previously been kept low through monopsony power or some form of bondage or (b) the country happened to be in the fortunate situation in which it could safely at the same time expand total demand by macroeconomic means. In the absence of either (a) or (b), it might still be the case that the regulation increased the share of total income going to wages. But, even if that were so, it could still be expected to move some workers out of the formal economy, either to no work at all or into the informal sector. Any informal-sector work into which they transferred would presumably be less desirable than the work from which they had been moved; otherwise, they would already have chosen it in preference. Also, the movement itself would tend to reduce the returns to work in the informal sector, a change likely to be adverse for the poor.

Except in the special circumstances mentioned, at least some workers would likely be impoverished by attempts to raise wages by regulation. This presents a dilemma for policy. How far working conditions should be regulated, even in the interests of workers' health and safety, when the regulation, by raising costs, is quite likely to reduce modern-sector employment? There will be gainers and losers from any rules imposed. Whatever compromise is chosen, there will probably be narrow limits at best within which poverty can be reduced by regulating wages upward. The one-dollar or two-dollar absolute-poverty headcount might be increased. So the functional distribution itself may appear resistant, except in the rather long term over which extensive investment is possible, to moves that might be made by government policy.

However, besides undertaking and encouraging investment that will increase the endowments of 'physical' and human capital over that of unskilled labour, the policy may also encourage (or at least not discourage) the pattern of demand to shift toward more intrinsically labour-intensive goods. For low-wage countries this shift can often be promoted by opening the economy to more uninhibited overseas trade, which will often favour more-labour-intensive exports and less-labour-intensive imports, moving the low-wage economy’s production in a labour-intensive direction, which in that case would also be the general direction of its comparative advantage. The government may also to some degree tilt public-sector expenditure in a labour-using direction, and it may for the same purpose remove any internal subsidy or privilege (as on the import of capital goods or the use of fuel) that would increase the incentives for substituting other factors for labour. Opening to inward direct investment will also tend to bring technical and managerial skills and know-how. These, even if they are not transferred to the local population (as some surely will be), still contribute to the current national income and to raising the unit returns to unskilled labour.

A further possibility of acting in an equalizing direction on the distribution of pre-tax incomes is to redistribute the ownership or usage rights of productive assets, notably land (as in the radical land reforms of Japan and Taiwan after the Second World War), and also to redistribute the shares of skills among households by reducing the preferential access that richer families may otherwise have to acquire them. So, even if it is the case that there are no real opportunities for extensive cash transfers to the very poor, other routes are potentially open to government policy, even in the relatively short term, for reducing the extent and depth of absolute income poverty. Incidentally, if there are no real opportunities for cash transfers relevant in size to the extreme-poverty gaps, this, for all but the lowest-income countries, would appear to be primarily for administrative and political reasons rather than because it would make unreasonable demands on the richer sections of the countries' populations, let alone on the richer part of the world.

In some middle-income countries, they imply, the cost for saying the richest fifth of the countries’ populations for clearing their one-dollar poverty entirely would be utterly trivial. Even for some of the low-income countries, the cost would not be inordinate, and for the rich world eliminating one-dollar poverty from all the low-income countries might require only say tripling official development assistance from its current level. We stress that these calculations are hypothetical – but in many cases only because of the administrative and political difficulties, not because they would make extravagant demands on the rich in low- and middle-income countries or on the rich world.

However, the political and administrative difficulty of attacking poverty by this route turns our attention to direct action on public facilities and programmes for health, education, water, sewerage, and the rest. Some of these have a public-good character and are necessarily enjoyed by all if they are provided at all. Others, though not intrinsically public goods, may be treated as merit goods and laid open to all without charge or means test. In either of these cases, such provisions avoid the administrative problems of benefits designed to be confined to the poor. Some of them, by increasing human capital and spreading it more widely, may not only contribute to economic growth, as suggested in the next section but also increase differentially the productive assets in the hands of the poor.

Nevertheless, consideration of the realities determining the functional distribution calls attention to an ultimate limitation. Despite the various ways mentioned here by which poverty might be reduced by redistributing assets or giving the production a more labour-intensive cast, we probably have to recognise that general affluence of the degree achieved by Taiwan and South Korea will be impossible without prolonged public and private investment in direct production, physical infrastructure and skills so that income and output grow at a rate sufficient eventually to render unskilled labour increasingly scarce. Some patterns of production rather than others will help the process along and reduce the time or the volume of investment needed to reach any degree of affluence. Expanded basic-needs provision of public and merit goods can make the intervening period more tolerable for the poor, but, without the investment in capital assets and skills that is fast enough first to mop up surplus labour and then to keep progressively farther ahead of the growth of the workforce, the elusive affluence cannot be attained.

Self-Assessment Exercise 4

1. Highlight the ways by which poverty can be reduced

3.7 Summary

In this unit, we discussed that poverty is a global mass phenomenon. It is not a simple concept; rather it is complex, dynamic and multi-dimensional. The phenomenon presents itself as a situation of pronounced deprivation of all kinds which could be material or non-material; and income of human poverty. As far as operational definition is concerned, the understanding of poverty has evolved considerably from a simple notion of low income and low consumption, characterized by poor nutrition and poor living conditions. It is becoming more apparent that poverty is far more complex than material deprivation with mere emphasis on income. This traditional notion of income poverty has thus given way to the idea of human poverty. The concept of human poverty is an attempt toward having a comprehensive understanding of poverty, having realized the multidimensionality of the phenomenon.

3.8 References/Further Readings/Web Resources

Badejo, R. A., (2014). Introduction to Development Economics: Poverty, Corruption and the Nigerian Economy, 1st Edition. Lagos: Grey-way Publication Limited.

Corden, W. M. (1984). "Boom Sector and Dutch Disease Economics: Survey and Consolidation". *Oxford Economic Papers. 36*: 362.

3.9 Possible Answers to SAEs

These are the answers to the SAEs within the content

Answers to SAEs 1

1). The poverty line is a basic measure and an instrument for identifying and measuring income poverty. It is defined as an arbitrary income measure, usually expressed in constant dollars (e.g. $1 per day), used as a basis for estimating the proportion of a country's population that exists at the bare level of subsistence. Based on household income or consumption, poverty lines quantify absolute poverty in monetary terms and characterize people in terms of their monetary income or consumption, particularly of food. Thus, a poverty line is just a cut-off line (or threshold) used to distinguish between "poor" and "non-poor" households.

2). Setting a poverty line permits the calculation of the following poverty indicators:

(i). Poverty rate or incidence of poverty: An estimate of the percentage of people living below the poverty line.

(ii). Depth of poverty or poverty gap: The average distance below the poverty line, expressed as a percentage of that line. It is also called the poverty gap as it shows the average distance of the poor from the poverty line.

(iii). The severity of poverty: A weighted average of the squared distance below the poverty line, expressed as a percentage of that line. The weights are usually given by each gap. Since the weights increase with poverty, this measure is sensitive to inequalities among the poor.

Answers to SAEs 2

1). Simon Kuznets concluded from the cross-sectional comparison that inequality, as measured by the proportional shares of various income-quintiles, tended first to increase as one moved from lower to higher per capita incomes and then beyond a certain income level to fall. This pattern could be represented by an inverted U-shaped curve, the Kuznets curve, with inequality on the vertical axis and per capita income on the horizontal. The policy implication of the inverted U-curve is that rising inequality had to be accepted in the 'early' stages of growth, and that interfering with distribution in the direction of equalization would tend to inhibit growth. This view could be attacked on various grounds. The first was that the observed relationship between income level and distribution was not a close one. Several other factors showed relationships with income distribution. Secondly, the association was not necessarily causal in the direction the argument would imply.

Answers to SAEs 3

1). A ‘vicious circle of poverty explains the trap by low or zero rates of net saving (and hence of investment and economic growth) that could be expected with incomes below a certain level. Collier explains African countries' plight by expounding various 'traps' that interact negatively with increasing poverty and with each other. Those traps most obviously aggravated by poverty and also contributing to it are what he calls the 'conflict trap' and bad government. The implication is that, without some route to significant growth, conditions are likely to become cumulatively worse.

Answers to SAEs 4

1). The functional distribution of income refers to income distribution among factors of production, before taxes and transfers. The factors of production are commonly simplified into three or four: land, labour, and capital, with human capital commonly a fourth. In a market economy returns per unit to the various factors will be determined by their relative scarcity. In the logic of the functional distribution of income, policy to increase the gross (i.e., before-tax-and-transfer) income of the very poor can be expected to be largely dependent on either transferring to the poor possession of larger shares of the other factors or increasing the economy's stocks of the other factors. Poverty might be reduced by redistributing assets or giving production a more labour-intensive cast.

UNIT 4: PRIORITY FOR GROWTH-TARGETED VERSUS POVERTY-TARGETED INTERVENTION

Unit Structure

4.1 Introduction

4.2. Learning Outcomes

4.3. Strategies of Growth Led and Support Led Security and Unaimed Opulence

4.4. Famine: Prevention and Alleviation of Famine

4.5. Social Safety Nets

4.6. Summary

4.7. References/Further Readings/Web Resources

4.8. Possible Answers to Self-Assessment Exercises (SEAs) within Content

4.1 Introduction

The concept of redistribution with growth is attributed to Hans Singer on the ILO mission to Kenya in 1971. The term is the title of a book by Chenery *et al.* (1974), setting out to re-orient the framework of planning for growth so that the benefits should be differentially distributed toward the poorer. By the late 1970s, Taiwan and South Korea seemed to be star examples of how rapid growth could be combined with low Gini coefficients and persisting or even increasingly large shares of total income for the lowest 40% of earners. The Chenery team proposed that planning for growth should separate the effects of particular measures according to their impacts on people at various income levels in the population and on groups otherwise defined as particularly poor such as landless rural labourers. We have mentioned their distribution-weighted growth estimates. Their cross-sectional analysis of the impact of several variables separated national income into three parts: earned by respectively the lowest 40%, the next lowest, and the top 20%. They found for example that the extent of primary schooling was positively related to the income share of the lowest 40%; the population growth rate, negatively; and the overall per capita growth rate, positively. Each of these three findings suggested at least that there need be no conflict between growth and poverty reduction (relative as well as absolute). The Taiwan pattern suggests that some important influence, other than overall growth, had affected the incomes of the poor in that period, even, as Fei, *et al*. point out, before the 'turning-point' out of the 'Lewis stage', and they find this influence in the radical land reform. In any case, the experiences of both countries certainly confirm the interpretation that there is no necessary conflict of priorities between growth and poverty reduction.

4.2 Learning Outcomes

By the end of this unit, you will be able to:

- Describe the meaning of strategies of growth-led and support-led security
- Define the meaning of famine and how to eliminate it
- Explain what is meant by social safety nets.

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4.3 Strategies of 'Growth-Led' and 'Support-Led Security' and 'Unaimed Opulence'

Dreze and Sen (1995) distinguish three policy approaches bearing on what they call 'endemic undernourishment and deprivation': namely 'growth-led security', 'support-led security', and 'unaimed opulence'. At the time they wrote (actually in the early 1990s), these were typified respectively in their view by South Korea; Sri Lanka and China (with Chile, Costa Rica, Jamaica, and Cuba also mentioned); and by Brazil. (They did of course recognize the extraordinary aberrations in China at times during the Mao period, and on the other hand, they might have put China into the growth-led category if they had been writing ten years later. A few years later again, and they might also have reclassified Brazil into that category.)

They distinguish the first two types by the priority in the time assigned to growth promotion as against direct welfare and redistribution measures, rather than by any suggestion of fundamental conflict between growth on the one hand and contemporary poverty reduction on the other. The growth-led policy does require in addition deliberate attention to poverty if it is to serve the purpose of enhancing human security. By definition, it gives high priority to growth from the first. Support-led security leads with directly poverty-reducing interventions, while the 'unaimed-opulence' strategy, attributed at the time to Brazil, relies wholly on economic growth, giving no particular attention to poverty in its selection of policies.

The growth-with-equity approach, as described by Fei, Ranis, and Kuo (1979) in their account of Taiwan, however, is not simply a growth policy tempered by poverty-reducing interventions. As they see it, what Taiwan had chosen was a growth policy with an equalizing cast written into it throughout. Their most important policy conclusion, as they present it is that: Economic growth can be compatible with improved distribution of income during every phase of the transition from colonialism to modern growth.

The success of Taiwan in this respect they attribute in part to features of its post-1945 endowment, such as a good rural transport network, but also the right policies. If we interpret the authors right, these allowed Taiwan to reallocate resources to make use of its endowments while at the same time, and often through the same policies, changing the distribution of income in an equalizing direction. Rural industrialization, promoted by avoiding policies that would positively have encouraged urban concentration, served both purposes; so did the country's abandonment of the promotion of first-stage import substitution. In place of this Taiwan moved to the export orientation which, from around 1960, allowed a rapid expansion of labour-intensive manufactured exports.

Fields, drawing on Ranis, identifies four strategies as responsible for Taiwan's success: strategies for decentralized development; for balanced rural development (expansion of non-agricultural rural industries); to do with industry and trade (open economy and export promotion), and for human resource development (1980). Fei and colleagues not only recognize the importance of income equalization of the radical distributive land reform that the island underwent in the early 1950s. They also highlight the fact that the economy reached a 'turning-point' around 1968, when urban wage levels began to rise consistently, imparting an equalizing tendency to the urban sector as land redistribution and rural industrialization had earlier done for the rural sectors.

Taiwan's 'growth with equity, which has considerable analogies with South Korea's experience, seems to be a good example of 'growth-supported security' in the classification of Dreze and Sen. The turning point, at which labour becomes 'scarce', marks an economy's exit from the Lewis world of 'unlimited supplies of labour', giving those with least economic power, provided that they are not brought down by illness or other personal disasters, the prospect of rising absolutely and perhaps also relatively. If a country starts with some degree of fit with the Lewis model and then grows fast enough and in a sufficiently equalizing way to reach the turning point, there are reasons for thinking that it is on the path to affluence. If it is possible, growth with equity on this pattern has considerable advantages for an initially Lewis-type economy.

However, the argument that can be made for 'support-led security', even when average income is comparatively low and its growth slow, is supported by cases in which poor countries have attained surprisingly high scores on certain welfare indicators. Sri Lanka was particularly notable here, at least until about 1990. Writing around then Sudhir Anand and Ravi Kanbur (1995) presented the case: The life expectancy at birth of a Sri Lankan is almost 70 years, which is a figure approaching that found in industrial market economies, and much higher than that typical of developing countries at similar or even higher levels of per capita income. Infant mortality rates in Sri Lanka are below 40 per 1,000 live births. The literacy rate is at 80% or more, compared with the developing countries average of around 50%.

Sri Lanka's pre-eminence in these respects has not been quite so clear since the early 2000s, though child mortality is still strikingly low and literacy is now close to 100%. Poverty headcounts and gaps are also low compared with other South Asian countries of similar income. From the perspective of the earlier date, Anand and Kanbur conclude that 'purposive and directed intervention has had considerable effects on health and education standards both in the early part of the century and in the period after independence. Moreover, from econometric analysis, 'income growth alone would not have achieved for Sri Lanka its enviable basic needs record'. The comparatively slow growth that might be associated with a support-led security strategy need not inhibit interventions that considerably improve living conditions for the relatively poor.

Self-Assessment Exercises 1

1. Discuss the strategies of 'Growth-Led' and 'Support-Led Security' and 'Unaimed Opulence.
2. List the four strategies for Taiwan's success

4.4. Famine: Prevention and Alleviation of Famine

From the experience of four African countries in the crop failures of 1983-84, Dreze (1995) gives striking evidence showing how human welfare can be safeguarded when the will and the understanding are there. These were the crop failures that affected much of the continent and presented the rest of the world with horrifying famine pictures from Ethiopia. Yet the four countries – Kenya, Cape Verde, Botswana, and Zimbabwe, one with low income, the other three low-middle – were able to prevent famine deaths or even reduce mortality and to maintain or in one case (Cape Verde) improve, nutrition, even though the four concerned suffered greater proportional food crop reductions (at least three times as great in two of the cases) than Ethiopia and Sudan where famine deaths were numerous.

A further well-known example of important aspects of human welfare is preserved in conditions of poverty in Kerala, one of the poorer Indian States, where some social indicators approach First World levels. Kerala's under-five mortality rate in 2000 was 19 per 1000 (contrasting with India, 95 and Uttar Pradesh [UP], the largest State, 123).

Its percentage of children receiving all vaccinations was 80 (India, 42; UP, 21); the percentage of births attended by a health professional, was 94 (India, 42; UP, 22). No doubt as a result in large part of such differences, giving the much higher probability of any child's surviving, Kerala's total fertility rate ('expected' births per woman over her lifetime at current age-specific rates 6) was as low as 2.0 (India, 2.9; UP, 4.0). This figure is comparable with that of the US or New Zealand and consistent in the long term with a stable and even slightly falling population (UNDP, 2005). It seems that nationally or regionally low income does not preclude important aspects of social provision.

Conversely, it is also the case that reliance cannot be placed on fast economic growth or a relatively high level of income for quick elimination of income poverty and adequate social provision. South Africa, an upper-middle-income country, admittedly at the time extremely affected by AIDS, had 2003 a life expectancy at birth of 48.4 years, comparable to those of low-income Kenya, Nigeria, and Ethiopia. Its under-five death rate of 66 per 1000 live births was comparable to that of Bangladesh. Above we have not disputed Fields' view that growth – other than of a kind that is sole 'modern-sector-enriching' such as that based on natural-resource proceeds that are purloined or squandered – can be expected to reduce poverty; but to what extent and how fast?

Growth of income might, as we have seen, act to increase or reduce inequality or leave the shape of income-distribution unchanged; but prevailing rates of growth in several countries on their own (without a change in distribution at the same time) would take a long time to eliminate extreme poverty. Projecting the impact of growth in itself on absolute poverty on the simplifying assumption that the existing distribution would remain, Ravi Kanbur (1991) estimated how many years of income-per-capita growth at the rate achieved over the years 1965-84 it would take to raise the average less than-one-dollar-poor person in each of nine Latin American countries over that one dollar-poverty line. Apart from Chile and Peru, which had shown negative per capita growth over 1965-84, and where the answer was, therefore, infinity, the number of years ranged from 14 in Brazil and 17 in Mexico to 98 in Argentina and 143 in Honduras. Even doubling the rate of growth would only halve the time. Remember this would be enough to raise only the average extremely poor person above the line, not by any means everyone currently below it.

Unaimed opulence as a policy objective, cannot be relied on to bring a timely solution to poverty. Unless there was reason to believe that growth in the particular case would of itself have a redistributive cast. Faster reduction of income poverty than could be expected to follow from maintaining a constant distribution of income as income grew would demand either that such a cast should be introduced by policy to the growth process or that there should be direct welfare-oriented intervention. As one possibility for such recasting, redistribution of assets across households, which could include not only land reform but also policies on human capital – training and education – that opened opportunities widely to help neutralize the advantages flowing from privileged family income, might be designed to promote both growth and equalization – to that extent speeding poverty reduction beyond the rate that would be set by aggregate growth in the absence of redistribution.

Furthermore, it is clear that raising minimal welfare standards in water, sanitation, health, and education and promoting improved food production will to a large extent require government action and public spending. Higher-income all around will certainly make this easier but will not guarantee it. At the same time, much of this welfare improvement will itself contribute to economic growth even if only in the longer term. It will not be generally competitive with growth promotion. However, at any one time, it may of course be competitive with particular valid means of growth-promotion, such as improvement of transport, power, and communication infrastructure.

However, we can further summarize as follows:

- Effective poverty reduction with equalizing policies and moderately high human-development standards, even in low-income countries and regions, are not necessarily impossible or indeed unknown, and suitable actions to this end are not inconsistent with economic growth.

- Relatively high income or rapid growth does not necessarily produce high levels of basic-needs provision and human development, though, given the will, it makes their achievement through appropriate policies easier.
- Growth of any significant magnitude with built-in equalization requires policy combinations designed to make full use of endowments of unskilled labour and opportunities for human-capital development.
- Resting content with negative or even zero per capita growth is risky because of its propensity to lead subsequently, through civil conflict or corrupt government or both, to progressively worsening conditions, including very probably increasing poverty.
- Public action to improve basic-needs provision and human development is not in general competitive with economic-growth promotion but at any one time may be competitive with particular forms of it, so that priorities may have to be set implying judgments of, among other things, time-preference.
- Though policies shifting allocation in an efficient and labour-using direction may facilitate both economic growth and equalization, and attention to basic-needs provision through public facilities may at the same time greatly ameliorate the welfare of the poor, the attainment of secure affluence by modern standards from low or low-middle income will require a sufficient rate of public and private investment over a sufficiently long period first to use up ‘surplus’ labour and then to make labour increasingly ‘scarce’.

The policy message is then both to move progressively into poverty reduction (basic needs and a bias to equalization, safety-nets if possible) and to remove impediments to growth, but to seek out ways that reduce any conflict between these objectives and measures and that have the effect of serving both.

4.4.1. Prevention and Alleviation of Famine

A famine can be said to exist in large numbers of people who simultaneously have so little access to food that their lives are threatened. Deaths from famine, however, commonly arise from diseases brought on by severe malnutrition, not necessarily from sheer starvation. A famine in this sense needs to be distinguished from a crop failure, however serious, which may or may not lead to famine. It also needs to be distinguished from chronic hunger and malnutrition, a much more difficult problem for a reasonably organized and well-motivated government to eliminate.

Much of what applies to famines applies to the aftermaths of natural disasters such as floods, cyclones, and earthquakes. In the latter cases, the causal events will probably be more difficult to foresee and hence the onset of the human damage will be more sudden. Moreover, the kinds of urgent and extraordinary needs will be more varied (shelter and water perhaps as well as food) and those in serious need may be easier to identify. Economic analysis of famines, extending to food deficiency generally, largely began with Amartya Sen in the mid-1970s; famous for the judgment that famines do not happen in democracies with a free press. This typified his starting point: famines are not natural events; they are social phenomena that have to be explained and combated by social arrangements.

Famines recurred in pre-independence India, culminating in the Great Bengal famine of 1943-4, in which millions died. There have been none in post-independence India: plenty of hunger and malnutrition, plenty of crop failures, but no famines. This is not because the climate has changed for the better. The main reason, in Sen's view, is changed political and social institutions. China had its last serious famine in the 'Great Leap Forward' time of 1959-61, in which tens of millions died. Another remotely similar event is not expected because the extraordinary political conditions of the time are not likely to return. But famines have been still regrettably common in sub-Saharan Africa.

The key concept in Sen’s account of famines is entitlement. Famines occur when large numbers of people lose their entitlements to food. A loss of entitlements means in the extreme that people have neither food produced by themselves nor money or other assets with which they can buy it. There may or may not be less food around than normal, though famine is usually precipitated by a crop failure. But, if people had enough money and enough warning, they could buy food from other localities or from abroad. On the other hand – even though there may be as much food grown as normal and importing it may be no more costly than before – if, because of economic disruption or civil conflict, large numbers of people lose their jobs and consequently their incomes, or much trading activity becomes impossible, there may, in the absence of radical government intervention, be no peaceful way in which the people who need it can get their hands on the food.

Why do famines, as Sen repeatedly reminds the world, not generally occur in democracies with a free and independent press? On the assumption that the generalization is true, the reason is surely something like this: that the onset or threat of famine becomes widely known and discussed; those likely to be affected complain; the press takes it up, and elected politicians take action to see that essential entitlement are maintained or restored.

For famine to be prevented, first there is preparation against the possibility of crop failure. Early-warning systems of abnormal weather can be and have been set up, though they are by no means infallible. What is essential is that there should be stocks of basic foods: stocks continually 'turned over and sufficient to cover the period from the time when shortages begin to be observed to when extra ordered supplies can be brought in. The supply of food needs to be adequate to meet basic needs. The necessary stocks and emergency supplies have to be procured, or at least backstopped by government action. Where collapse of food supply or distribution is possible, it is also important that administrative arrangements are in place for dealing with it promptly when it arises. What then needs to be done is to see that people have the resources and the entitlements to buy the food. Those in need may be farmers producing wholly or largely for their own needs, whom a crop failure will deprive of their income. Then there will be agricultural labourers who have lost their employment if there is no harvest work to be done and the farmers who would normally pay them have no income or motive for doing so. There may be others in industries that depend on agriculture who are similarly deprived; and, with a general fall in purchasing power, the range of affected industries may extend widely.

As far as possible, the state should aspire to keep up the general level of purchasing power through its macro-policy as well as that of the groups whose well-being and survival are most affected. The more nearly the general level of spending is maintained, the more the ranks of those severely affected or at risk and in need of extraordinary help will be reduced. What is counterproductive is to subsidize the staple food generally in response to the tendency of its market price to rise. Subsidy's first-round effect will be to increase demand from those that have purchasing power. It will do nothing for those who have none and if anything, it will discourage any tendency to economize on the part of those who still have enough food. If there is not a corresponding increase in supply, the consumer price after subsidy will move back towards its pre-subsidy level. In so far as the consumer price is reduced without an increase in supply, the subsidizing authority will be supplementing the incomes of those that have the entitlements to buy food. This may increase the share of the supply taken by those who have more to spend at the expense of those who have less and leave out entirely those who have nothing. If, on the other hand, the supply to the market can be increased to its normal level, with confidence established that the supply can be maintained, this will bring the price down to normal without the need for subsidy. Any subsidy to help deal with the inadequacy of certain people's entitlements to food will need to be closely targeted at the neediest if it is to serve its purpose, just as an increase in market supply will need to be supplemented by other measures to provide entitlements for those who otherwise would have no purchasing power at all or next to none. In short, both food supply and entitlements must be adequate if the symptoms of famine are to be avoided.

Also counterproductive in most circumstances (and certainly without other measures) will be controlled food prices. They will increase the opportunities for persecution and extortion to be practised on traders and will risk destroying the public markets and hence any efficient and reliable access for consumers to the food that there is. During whatever period supplies to the market cannot be restored – while at the same time the authorities themselves may well need to make claims on the limited supply, or else distribute claims on it, for the sake of feeding those who are destitute – the market-price must be allowed to rise. This will encourage the economy on the part of those that are above the level of subsistence and will give incentives for supplies to move in from less badly hit areas or from abroad.

Similarly, restrictions imposed by states or districts on the movement of food will aggravate problems in the worst affected areas. There will of course be gainers as well as losers from such restrictions, but on the reasonable value-judgement that the poorest have the most urgent claims – the highest welfare weightings at the margin – free flow will generate a net gain. Ethiopia in 1984 was one of the instances in which the food movement had been arbitrarily blocked. This does not for a moment imply that everything must be left to the market. When significant numbers of people – beyond the likely capacity of charity and informal arrangements to cover – are threatened, the state must step in, not only ensuring that, as far as possible, supplies are minimally adequate but also with feeding programmes, food supplements, coupons, or cash, for those in most need.

The problems that may arise are discussed in the next section on 'Social safety-nets. Ways have to be found of identifying those in serious need and excluding others. One way of doing this is category-targeting. That is, directing food staples or nutritional supplements to an easily identified category that collectively have a particular claim, such as young children and pregnant and nursing mothers, for whom the shortage of food is likely to have the most serious long-term consequences. Such programmes seem to explain why sometimes nutritional status in the most vulnerable groups improves in famines or threats thereof, as mentioned above for Cape Verde in 1983-84.

Another thing is to require work to be done on labour-intensive public projects as subsistence wages for those people who appear able-bodied. It commits the workers' time to the programme, this sifts out from support to those who might expect to be able to provide for themselves through the informal sector (Chu & Gupta, 1998). It is also held to have the advantage of preventing the emergence of a habit of dependency and preserving self-respect, which is often valued by the beneficiaries themselves. And, if proper preparation is made in advance to provide against the need for work programmes, they can do things of local or wider use, such as maintaining local roads, irrigation, soil conservation, and tree planting. Always invoked as a successful example is the Maharashtra Employment Guarantee Scheme in India in 1972-3 and again in the early 1980s. Chu and Gupta (1998) mention a similar scheme as preventing famine in Bangladesh in 1988, and relate that the African successes mentioned above in the crop failures of 1983-84, as in Cape Verde and Botswana, also used targeted public works. An example from the US (Friedman, 2007) is the Civilian Conservation Corps and the Works Progress Administration, set up in 1933, which directly provided work for 8 million people rendered unemployed in the Great Depression, and created several public buildings and other great public projects still in use seventy years later.

A further lesson from bitter experiences, such as that of Ethiopia in the 1980s, is that as far as possible food should be moved to people rather than people to food. For already weakened people to walk over long distances and assemble with huge numbers of others, also weak and many already sick, is a lethal recipe. Only the worst policy failures and delays are likely to make this concentration of feeding centres necessary. In general, what seems to be needed is a combination of prompt and well-prepared government action; no arbitrary blockage to adjustments made by the market, and reliance for certain purposes, especially for help with fair distribution, on civil society.

Self-Assessment Exercises 2

> 1. Describe briefly what is meant by “Famine”
> 2. How will the government help to prevent famine in an economy?

4.5. Social Safety-Nets

The idea of a social safety net has two related connotations. One is protection against adverse change, a device to reduce risk, the purpose to which private insurance is directed. The other is a system of support to bring everyone up to some minimum standard of material well-being. In practice, the two cannot be readily distinguished. Either one provided by the state conveys elements of the other. We are concerned here with people in developing countries for whom any form of private insurance is likely to be out of the question. They consider themselves too poor to buy the insurance and probably they would not in any case be considered insurable by those who purvey insurance policies. So we are concerned with social safety nets, that is, those provided by ‘the community, namely the state, possibly with some input from civil society.

Several developing countries have ‘social-insurance’ schemes, but usually for relatively privileged workers in the public sector, to provide retirement income and benefits in the case of illness or premature incapacity. These are framed like private insurance, at least to the extent of having contributions from the insured people and their employers; though there is often a degree of state subsidization as well. Access to these schemes can be an important benefit attached to certain forms of employment. They allow risks to be spread and also help in the spreading of disposable income over time. Here we consider safety nets only for those who fail outside the range of these privileges.

One component of the security aspect of safety nets can be provided by the stabilization of the macroeconomy. Benefits may also be given to workers who lose their means of livelihood as a result of policy changes such as the removal of trade protection. These latter have been advocated in IMF publications as facilitators of efficiency-directed economic reform in that they are expected to reduce political opposition to it. They have been provided in the US, for example, where other safety-net provisions provide less of a cushion against personal disaster than in most other rich countries. They have the awkward feature for a policy that they have to be framed to some extent ad hoc.

We concentrate here on the forms of safety net that are in some places, or might be, provided routinely in developing countries. Developing countries here include middle-income, even upper-middle-income countries; among which are several 'transition countries. These have often kept a form of the social-security provisions inherited from their ostensibly Marxist pasts. They may provide models that other middle-income countries can follow. However, setting these models from ‘transitional’ countries aside, we are faced with the possibilities of three ways in which state support to individual poor households may be given in cash, as goods in kind or coupons that allow goods of particular kinds (food, for example) to be bought; and in the form of free or highly subsidized access to public services such as schools or clinics.

The potential dilemma of safety-net provisions directed at the poor is the same one we have mentioned in connection with famine relief: to include all those regarded as needy for this purpose and to exclude others. If the intention with certain health and education facilities is in any case to make them free for all (as is the case with Uganda and Kenya, for example, over primary schooling), their provision without charge avoids this dilemma. On the other hand, where there must be a means test to fulfil the purpose of the support without excessive expense, there are real difficulties in reliably determining eligibility in any society, rich or poor, but especially where much income may be in non-cash form, where it is irregular, where record-keeping is not a common habit, and where the bureaucracy may be mediocre. The devices used must often be compromised, excluding some of the targeted poor or including some of the non-poor, or both. To this end, some performance conditions may be imposed on the benefits, or their use may be restricted in various ways.

The issue of category-targeting as mentioned concerning famine relief is one compromise. Food supplements or standard food may be provided for children, or for children who on objective signs are malnourished, for pregnant and nursing mothers, and perhaps also for old people living alone or serving as principal earners for their households. In a situation where improving nutrition is an important objective, an ostensibly poor family may either be given nutritious foods directly or be given coupons that can be exchanged for food, or certain kinds of food, alone. The coupon method (and cash even more so) can be regarded as more efficient in the traditional economic sense than the food provided in kind in that it gives the recipient greater choice, but by the same token coupons may be less reliable (and cashless so again) in directing the benefits to nutrition. However, food given directly may also be traded unless it is provided in prepared form through schools or feeding centres, and the alternative of giving the benefits in the form of food coupons – or, even more so, cash – allows the same result to be realized but much more conveniently. Even if it is the nutrition of children that is in question, it can be questioned whether attempts should be made to constrain the choices of parents in these ways rather than trusting them to decide in their children's interests. In neither of the last two cases mentioned is there any ready guarantee that the non-poor will be excluded, and judgements of fact may also have to be made over category targeted benefits? Often the size of any land a family possesses, household composition, the character of their dwellings and their occupations may give enough indication. These are situations in which users might well be made of 'civil society in the form of neighbours, local leadership, or anybody representative of the village or commune to help establish the relevant facts. Such use is made now in Bangladesh for determining who is eligible for rudimentary safety-net payments for the destitute old.

The same use of local institutions might be invoked in the absence of adequate government funding to have local responsibility accepted for minimal support of the destitute. Models in which something of the sort happened come from modern China, at least in the intervals and areas of comparative normality between 1962 and the reforms of the 1980s, and from England under the 1601 Poor Law, which remained in force for over 200 years, before giving way to the much less humane 1834 Poor Law associated with the workhouses and fixed in public memory by Oliver Twist.

4.5.1 Some Social Safety Nets Adopted in Nigeria

Social safety nets are part of broader social protection systems comprising non-contributory transfers in cash or in-kind, designed to provide support for the poor and vulnerable (World Bank, 2019). Social safety-nets play some important roles. For example, they help alleviate poverty, food insecurity, and malnutrition; they contribute by reducing inequality and boosting shared prosperity; they support households in coping with shocks; they help build human capital and connect people to job opportunities, and they are an important factor in shaping social contract between the government and citizens.

In Nigeria, the flagship programs that are targeted to help the poor and vulnerable include the National Cash Transfer Office (NCTO), which implements cash transfers to targeted vulnerable households; Youth Empowerment and Social Support Operations (YESSO), supporting vulnerable youths with life skills training, grants and reorientation; and the Community and Social Development Project (CSDP) providing grants to boost the development agenda of vulnerable communities. These programs were encapsulated in the Government of Nigeria's National Social Safety Nets Project (NASSP).

Self-Assessment Exercises 3

1. Explain the term "Social Safety-Nets"
2. Highlight the programmes targeted at helping the poor in Nigeria

4.6 Summary

We discussed the strategies of growth-led and support-led security and unnamed opulence, the meaning of famine, how famines are prevented and social safety nets. The National Social Safety Nets Project is part of the government's policy of growth and social inclusion aimed at addressing poverty, which is one of the social challenges facing Nigeria. With support from the World Bank; the project seeks to, among other components, support targeted/selected poor households with monthly cash transfers. This is with the hope of laying the foundation for the government's long-term objectives of targeting and delivering safety nets to poor and vulnerable households across the nation.

4.7 References/Further Readings/Web Resources

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4.8 Possible Answers to SAEs

These are the answers to the SAEs within the content.

Answers to SAEs 1

1. Dreze and Sen identified three policy approaches bearing on what they call 'endemic undernourishment and deprivation': namely 'growth-led security', 'support-led security', and 'unaimed opulence'. They distinguish the first two types by the priority in the time assigned to growth promotion as against direct welfare and redistribution measures, rather than by any suggestion of fundamental conflict between growth on the one hand and contemporary poverty reduction on the other. The growth-led policy does require in addition deliberate attention to poverty if it is to serve the purpose of enhancing human security. By definition, it gives high priority to growth from the first.

   Support-led security leads with directly poverty-reducing interventions.

   The 'unaimed-opulence' strategy, attributed at the time to Brazil, relies wholly on economic growth, giving no particular attention to poverty in its selection of policies.

2. Fields, drawing on Ranis, identifies four strategies as responsible for Taiwan's success, namely: (i) strategies for decentralized development; (ii) for balanced rural development (expansion of non-agricultural rural industries); (iii) to do with industry and trade (open economy and export promotion), and (iv) for human resource development

Answers to SAEs 2

1. A famine can be said to exist in large numbers of people who simultaneously have so little access to food that their lives are threatened. Famine is usually precipitated by a crop failure. But, if people had enough money and enough warning, they could buy food from other localities or from abroad. Deaths from famine, however, commonly arise from diseases brought on by severe malnutrition, not necessarily from sheer starvation. Much of what applies to famines applies to the aftermaths of natural disasters such as floods, cyclones, and earthquakes. In the latter cases, the causal events will probably be more difficult to foresee and hence the onset of the human damage will be more sudden.
2. The government can present famine through preparation against the possibility of crop failure. Early-warning systems of abnormal weather can be and have been set up, though they are by no means infallible. What is essential is that there should be stocks of basic foods: stocks continually turned over and sufficient to cover the period from the time when shortages begin to be observed to when extra ordered supplies can be brought in.

   Secondly, the state should aspire to keep up the general level of purchasing power through its macro-policy as well as that of the groups whose well-being and survival are most affected. The more nearly the general level of spending is maintained, the more the ranks of those severely affected or at risk and in need of extraordinary help will be reduced. In so far as the consumer price is reduced without an increase in supply, the subsidizing authority will be supplementing the incomes of those that have the entitlements to buy food. If, on the other hand, the supply to the market can be increased to its normal level, with confidence established that the supply can be maintained, this will bring the price down to normal without the need for subsidy. In short, both food supply and entitlements must be adequate if the symptoms of famine are to be avoided.

Government can provide ‘Social safety-nets to those in serious need through category-targeting. That is, directing food staples or nutritional supplements to an easily identified category that collectively have a particular claim, such as young children and pregnant and nursing mothers, for whom the shortage of food is likely to have the most serious long-term consequences.

In general, what seems to be needed is a combination of prompt and well-prepared government action; no arbitrary blockage to adjustments made by the market, and reliance for certain purposes, especially for help with fair distribution, on civil society.

Answers to SAEs 3

1. The idea of a social safety net involves protection against adverse change, a device to reduce risk, and the purpose to which private insurance is directed. It is a system of support to bring everyone up to some minimum standard of material well-being. In practice, the two cannot be readily distinguished. Anyone provided by the state conveys elements of the other. Social safety nets are part of broader social protection systems comprising non-contributory transfers in cash or in-kind, designed to provide support for the poor and vulnerable. Social safety-nets play some important roles. For example, they help alleviate poverty, food insecurity, and malnutrition; they contribute by reducing inequality and boosting shared prosperity, etc.
2. In Nigeria, the programs that are targeted to help the poor and vulnerable include the National Cash Transfer Office (NCTO), which implements cash transfers to targeted vulnerable households; Youth Empowerment and Social Support Operations (YESSO), supporting vulnerable youths with life skills training, grants and reorientation; and the Community and Social Development Project (CSDP) providing grants to boost the development agenda of vulnerable communities. These programs were encapsulated in the Government of Nigeria's National Social Safety Nets Project (NASSP).