INTER-UNIVERSITY CENTRE: NOTES

Vicious Circles and Poverty Traps: Old and New Ideas About Underdevelopment

In recent years, some leading economic theorists have been rediscovering and reformulating old insights into the persistence of poverty in the developing world, in the form of mainstream theoretical models. Three ideas seem to be enjoying this kind of revival:

(1) The classical idea of the 'vicious circle of poverty', enunciated by Ragnar Nurkse in the 1950s, was summed up in the trite phrase 'a country is poor because it is poor'. Various causal mechanisms were suggested in order to explain this. For example, a poor county is characterised by low purchasing power and insufficient demand for new goods and therefore a weak incentive to invest, which results in a low level of capital stock, which condemns it to low productivity and consequently persistent poverty. The solution suggested by Nurkse, drawing on an earlier idea of Paul Rosenstein-Rodan, was that while investment in a single industry would be unprofitable because of the smallness of the market, simultaneous investments in different industries would generate incomes and thus a demand for each other's products. This idea has been formalised by Murphy, Shleifer and Vishny, who bring out the assumptions under which the economy might be stuck in a low-level equilibrium and when such demand spillovers can raise it to a higher level equilibrium. More recent work by K. Matsuyama also shows how there can be multiple equilibria of this kind.

(2) A different kind of vicious circle was postulated by Harvey Leibenstein, again in the 1950s. Poor people were undernourished and therefore incapable of much effort. Their productivity, as a result, was low and they remained poor. This has been recently reformulated by Partha Dasgupta and Debraj Ray as a theory of 'efficiency wages': poor people with no non-labour sources of income are malnourished and unproductive, and therefore unattractive to employers. Thus, the people who need employment most are not hired.

(3) In the 1950s, Nicholas Kaldor developed a growth model in which growth of production stimulated technical progress and thus more investment and growth. A stagnating economy could get trapped in poverty because it did not generate this kind of cumulative growth impulse. One of the frontier areas of economic theory today is the modelling of 'endogenous growth' along similar lines (although Kaldor is seldom acknowledged). The

key idea is that expansion by one firm involves innovations or learning new skills by its workers, and some of these benefits spill over to other firms.

The new models strongly suggest that an economy's trajectory depends on its initial conditions ('history matters'); that some countries can experience rapid growth while others stagnate, and that there is no necessary economic convergence between countries; that temporary slumps or booms, whether fortuitous or caused by government policies, can have long-lasting cumulative effects on the economy's development ('hysteresis'); that sensible government intervention is needed to lift countries and individuals out of their 'poverty traps'; and that growth is compatible with greater equity. While these conclusions may seem obvious to non-economists, they run against the consensus of development economics of the 1970s and 1980s which still dominates the policy discourse. The revival of some of the 1950s ideas, now being couched in formal models acceptable to mainstream economists, should be able to shake this consensus. I have been examining the continuities and discontinuities between the earlier writings (which were generally verbal) and the more recent literature (which is invariably more technical and mathematical) to find out what (if anything) has been lost or gained, and whether there are any other old ideas that are suitable for reformulation in modern theoretical terms.

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Economy and Institutions: Essays on Goa

The monograph just completed at the Inter-University Centre is entitled 'Economy and Institutions: Essays on Goa'. It consists of twenty essays that deal with the changing structure of some important institutions in Goa. An attempt is made to formulate explanatory mechanisms to capture their essential characteristics. The range of topics covered vary from fiscal and budgetary policy, to migration, tourism, the politics of government formation, corruption, and status and its links with unemployment. The tools used are mainly from the discipline of economics but the issues are contextualized within a wider social science perspective. We look on institutions as the rules and conventions that specify the options for action open to individuals and in the process define their rights, privileges and responsibilities. Citizens attempt to influence the formation of, as well as change existing rules and conventions that define how various institutions operate as well as their actual functioning so as to gain favourable outcomes to themselves. In the process the distribution of the benefits and burdens from various economic and other endeavours in society will be determined. In what follows I shall summarise four of the themes that the book deals with.