Some Economic Aspects and Problems of Under-Developed Countries

By

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"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—Eugene Black

President, World Bank

INTRODUCTION

The economic development of under-developed countries has rightly been stressed as the major problem of the twentieth century. Among the leading economists of the world who have exercised their minds on this important problem is Prof. P. T. Bauer, Smuts Reader in Commonwealth Studies and the Fellow of Gonville and Caius College of the University of Cambridge. He is author of two well known books on the Subject: "Economic Analysis and Policy in Under-developed Countries" and "The Economics of Under-developed Countries" (co-authored with Prof. B. S. Yamey).

When Prof. Bauer visited India recently, the Forum of Free Enterprise was glad to have the opportunity of presenting him to the Indian public. His two lectures on "Economic Progress of Under-developed Countries" delivered in Bombay on September 8 and 9 were greatly appreciated for their authoritative nature and thought-provoking contents. Prof. Bauer's approach is fresh and invigorating as the following pages would convince the reader. We are, therefore, glad to print the text of the lectures in the form of this booklet.

Let me, on behalf of the Forum of Free Enterprise, take this opportunity to express our sincere

and heartfelt thanks to Prof. Bauer for delivering the lectures and for taking the trouble of editing the transcript, and giving us the permission to reproduce it.

A. D. Shroff
President, Forum of Free Enterprise,

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In these two lectures I shall deal with some economic aspects of under-developed countries, some influential ideas on under-developed economies, and also with some issues of development policy. I want to consider especially some pervasive ideas which underlie current discussion on policy, and which also profoundly affect Indian economic planning.

In the course of the last ten or fifteen years, there has been a vast increase of interest in economic development, especially of underdeveloped countries. Their economic position and prospects have become principal issues in international politics. For instance, Mr. Hammarskjoeld, the Secretary-General of the United Nations, said in an official address in Geneva in July 1955 that their economic development was "the major long-term economic problem (of the present generation), the greatest economic challenge to all nations, both individually and collectively . . . the United Nations' chief task."

Economic development is as old as humanity, and speculation about it goes back to the classical economists of the 18th and 19th centuries, and

beyond them to the Middle Ages and, indeed, to antiquity. But the ideas which now dominate the discussion are very different from previous notions; and it is these new ideas which set the intellectual framework of contemporary discussion of policy in this vitally important sphere. They are reflected in such influential writings as in the books of Dr. Gunnar Myrdal, who is now in India, notably his widely read book An International Economy and Professor Ragnar Nurkse's book Problems of *Capital Formation* in Under-developed Countries, and they set the tenor of the vast United Nations literature on the subject, including the publication of ECAFE and the well-known U.N. Report on Measures for the Economic Development of Under-developed Countries, of which Professor Gadgil was a signatory, and they also dominate the most influential Indian thinking in the sphere as is clear from the literature of the Planning Commission, the writings of influential Indian economists and the pronouncement of cabinet ministers.

Let me begin by summarising the principal arguments of this dominant set of ideas. Its cornerstone and leading theme is the alleged presence of a vicious circle of poverty and underdevelopment. This thesis is presented in several distinct and different variants, which, however, are not exclusive but cumulative. The most frequent suggestion is that the low level of income renders saving impossible, thus preventing the capital accumulation necessary for an increase in income. Others include the suggestion that the narrow markets of low-income countries obstruct the emergence and extension of the specialisation necessary for higher incomes; that demand is too small to permit profitable and productive investment; that government revenues are insufficient for the establishment of effective public services; that malnutrition and poor health keep productivity low, which prevents a rise in income; and there are others as well. The stagnation of the under-developed world is said to reflect the failure of the traditional forces of economic progress, such as development of production for the market and of international exchange and private investment. The vicious circle can be broken only by drastic national and international action.

Here are a few typical formulations of the thesis of the vicious circle. Professor Paul A. Samuelson writes in *Economica,* probably the most widely used economic text in the Western world:

> "They (the backward nations) cannot get their heads above water because their production is so low that they can spare nothing for capital formation by which their standard of living could be raised."

Here is another formulation, this time from a study prepared for an official United States committee by the Center for International Studies of the Massachusetts Institute of Technology:

> "The general scarcity relative to population of nearly all resources creates a self-perpetuating vicious circle of poverty. Additional capital is necessary to increase output, but poverty itself makes it impossible to carry out the required saving and investment by a volun-

tary reduction in consumption."

As the developing countries are progressing substantially, there is, according to these ideas an ever-widening gap in income, capital, standard of living and rates of growth between the developed and underdeveloped world. Dr. Myrdal writes in ***An International Economy:***

> "It is the richer countries that are advancing while the poorer ones with the large populations are stagnating. For mankind as a whole there has actually been no progress at all. . . . As Mr. H. W. Singer has rightly pointed out, world real income per capita, and with it the standard of living of the ***average*** human being, is probably lower now than twenty-five years ago, and perhaps lower than in 1900, because the nations that have rapidly raised their economic standards have been a shrinking proportion of the total world population."

This last statement, which also reflects very influential and widely held views, is both unsubstantiated and also meaningless.

There are no series of national income figures for any Asian or African countries before the First World War and only a few most speculative estimates for individual years or periods for the inter-war years. Even if the statistics were available, it would be difficult to use them as a basis for meaningful comparisons because of fundamental changes in the conditions of living in many underdeveloped countries over the last half century. This conclusion is reinforced by another consideration of a

slightly more technical nature. Those of you who have studied elementary statistics will realise that the passage I have quoted reflects a misuse of the concept of the average. The median income could fall even if individual incomes rise everywhere if population increases much faster in poor countries than in richer countries. This is because an average can fall even if all its component elements increase, if there is a change in the relative importance of these component elements, i.e., a change in weights. It is clearly meaningless to say that there has been no economic progress in these conditions.

To return to the main argument of the dominant set of ideas. The adverse effects on private saving and investment of the low level of income are said to be reinforced by certain economic shortcomings of the population, such as a general inability to take a long view, an unwillingness of the few rich people to save and invest, and a dearth of constructive entrepreneurship, reflected in a greed for quick returns, and a lack of innovating ability. According to these ideas international private investment cannot alleviate the situation, since one aspect of the vicious circle is a lack, of profitable private investment opportunities.

Large-scale compulsory saving and comprehensive development planning are deemed necessary to break the vicious circle. The need for development planning is regarded as self-evident. One aspect of such policies is large-scale state support or ownership of manufacturing industry, the development of which is regarded as a condition of economic advance.

The national measures must be supplemented by large-scale inter-governmental grants or subsidised loans because underdeveloped countries are too poor to raise sufficient capital to break the vicious circle. Failure to achieve this would imply continued stagnation or even retrogression of the under-developed world and an ever-widening gap in living standards, with the probability of political catastrophe on a world scale.

Most of these ideas are demonstrably wrong.

These ideas first assume or state explicitly that the poverty of underdeveloped countries establishes a basic similarity in the conditions of their economic advance. The underdeveloped world so treated in most of these discussions includes virtually the whole of Asia (except Japan), all of Africa, almost the whole of Latin America (with the occasional exception of the Argentine and Uruguay), the Caribbean area, and most of Southern Europe; about two thousand million people, over-two-thirds of the world's population, inhabit these areas.

When considering the economic position, the development prospects, and the possible methods of economic advance of underdeveloped countries or their capital requirements, it must always be remembered that the greater part of the world is being discussed, and that this is not a stagnant homogeneous mass, but a vast aggregate of great diversity in such matters as population density and growth, political and social institutions, rates of progress, the economic qualities of the population, and many other respects. It includes areas which have

largely stagnated in recent decades, such as parts of Central America and of the Caribbean, or Liberia or Ethiopia, or parts of India and Pakistan, and also countries which have advanced very rapidly, such as Columbia, Venezuela, Ghana, Nigeria, Malaya and Hong Kong; very densely populated regions such as Java, much of India and Pakistan, and sparsely populated areas such as Sumatra, Borneo, most of Africa, and Latin America; traditional and highly stratified societies such as those of India and Pakistan, the Moslem Middle East, most of Africa, and the much more fluid societies of South-East Asia, West Africa and Latin America; the semi-deserts of the Middle East and East Africa, and the tropical jungles of Africa, Asia and Latin America; the thriving modern cities of South-East Asia, the tens of thousands of custom-ruled villages of the Indian peninsula, and the tribal communities of Africa. Underdeveloped economies do indeed exhibit certain common features, which justifies limited generalisations for certain purposes. For instance, the comparative importance of subsistence production in most underdeveloped countries is one such general aspect. However, for many other purposes, especially in the framing of policy, it is essential to remember their deep-seated diversity.

The leading theme of the dominant set of ideas, the vicious circle of poverty and stagnation, is manifestly invalid. Most obviously it is refuted by the very existence of developed countries, for the simple reason that all these began as under-developed. If the rigid formulation of the thesis of the vicious circle of poverty were valid, no country

could ever have developed. The countries which are now developed all began as under-developed countries, and they advanced usually without appreciable external capital, and almost invariably without grants from abroad. Of course, more generally the thesis of the vicious circle is refuted by the rise to prosperity of many poor individuals and groups throughout the world, including the prosperity and massive capital formation by originally penniless immigrants in many parts of the world, including the underdeveloped world. Examples of such capital formation include that of the penniless Chinese immigrants in Malaya, very poor Indians in East Africa, Jews in South Africa, Lebanese in West Africa, the West Indies and Brazil, not to speak of the vast capital accumulation in the United States and Canada by very poor immigrant communities.

The rapid economic advance of many underdeveloped countries in recent decade, which again refutes the allegation of a generally operative vicious circle of poverty and stagnation, is of special interest and relevance because it shows that forces which have made for economic advance in the earlier history of developed countries still operate in many parts of the underdeveloped world. Here is some evidence on this subject.

According to the statistics of the Economic Commission for Latin America over the period **1935** to **1953** the gross national product in Latin American countries increased at an annual rate of **4.2** per cent, and output per head by **2** per cent. Over the period **1945** to **1955** the rate of growth was even faster, as output per head increased by **2.4** per cent

annually (appreciably higher than in the United States), and total output by about **4.7** per cent.

South-East Asia and West Africa are other parts of the under-developed world which have developed very rapidly in recent decades. For these regions there are no series of national income figures going back before the second World War. At present the national income of Malaya is about **6,100** per head **per** annum, and that of Ghana (formerly the Gold Coast) about £60. These are very low levels compared to Western countries, but they reflect substantial advances over the last half-century or so, because around **1900** these were still essentially subsistence economies. There is much further information on the rapid advance of these regions. Statistics of foreign trade are of particular interest in West Africa, because imports are very largely for the use of Africans, and all agricultural exports are produced by them as there are practically no European-owned plantations in British West Africa.

Around **1900,** total annual imports and exports of Nigeria were each about £2 million, while by now they are each about **6,140** million; for Ghana the corresponding annual figures are about £1 million and £90 million. Over this period, there has been a spectacular increase in imports of both consumer and capital goods into these territories. In **1900** there were no imports, or only negligible imports, into these territories of flour, sugar, cigarettes, cement, petroleum products or iron and steel. Today these are on a massive scale. Exports of cocoa, groundnuts or cotton from Nigeria or Ghana

were negligible in 1900, while exports of oil-palm produce from Nigeria were about one-tenth of their present volume. Today these are staple exports of world commerce, and annual shipments are hundreds of thousands of tons.

There is much other evidence of the rapid economic advance in these territories in statistics of government revenue, literacy, health, railway returns, and the like.

The economic development of Malaya over the last sixty years or so has been even more rapid. Domestic exports from Malaya in 1900 were about £7-£8 million annually; by now they are about £250 million. At the turn of the century there were no exports of plantation rubber from Malaya; at present they are about 600,000 tons a year, over three-fifths produced on Asian-owned properties. There has also been a very rapid increase in the entrepot trade of the country, which reflects largely the spread of the money economy throughout South-East Asia. Thus, while in 1900 total Malayan exports and imports together (including re-exports) were around £50 million, at present the figure is about £900 million.

For all these territories statistics of public revenue, infant mortality, literacy, and railway transport all confirm the picture of rapid economic development. To give but one example, in Singapore the infant mortality rate fell from about 230 per thousand births in 1920-21 to about 50 per thousand births at present.

While I think Latin America, South-East Asia

and West Africa are among underdeveloped regions which have advanced most rapidly in recent decades, there has been substantial progress throughout the underdeveloped world. Even in India, where economic progress in recent decades has been slower than in many other underdeveloped countries, there is evidence of economic progress over the last half century from such information as the volume of industrial production, the increase in the literacy rate, the reduction of famine and disease, the fall in the infant mortality rate, the increased consumption of fresh fruit and vegetables, and the substitution of higher for lower quality food grains. These advances, especially the reduction in mortality, the decrease in epidemic diseases and the reduction in famine, are obvious from the simplest facts of Indian economic history.

The changes brought about by the economic advances in many underdeveloped regions, especially in South-East Asia and West Africa, but not only there, have been so far-reaching that conventional statistics such as those which I have already quoted cannot convey their full effect. In 1890's Malaya was a sparsely populated country of hamlets and fishing villages, where tribal welfare and communal raids were recurrent, and malaria was endemic. By the 1930's tribal warfare and communal disorder had disappeared, malaria was very largely suppressed, and the population had increased greatly, both through immigration and natural increase, and there had emerged a number of thriving and populous cities, linked by excellent communications. In West Africa around 1900 there was

still tribal warfare, slavery, slave raiding, and in places even cannibalism. Over large areas people had not yet invented the wheel or even seen one, nor had they evolved forms of administration beyond the village and the clan. In the same area today there are large admimstrative and trading centres with populations of over 100,000; and there are Africans owning large transport enterprises with fleets of thirty lorries or more. Such profound changes much affect the meaning of discussions whether differences in income per head between underdeveloped and developed countries have increased or diminished over the last half-century. I may say, I am convinced that they have been reduced, but that is another matter. The changes have been so far-reaching that the concept of income in the conventional sense is not helpful in expressing them.

The inadequacy of the conventional national income estimates for conveying such far-reaching changes is re-inforced by certain implications of the increase in population which has accompanied economic growth throughout the underdeveloped world. The population has increased greatly throughout the underdeveloped world over the last half century. Since 1900 the combined population of India and Pakistan, i.e., undivided India excluding Burma, increased from about 280 million to about 480 million; and over this period the crude death rate declined by almost two-thirds, from about 38 per thousand to about 14 per thousand. The population of Ceylon increased over this period from about 3½ to about 8½ million, and that of Ghana from about

1.5-1.8 million to about 4¼ million. These increases in population do not negate the reality of economic advance, but are rather evidence of it, since they reflect a fall in death rates resulting from the elimination of famine and of epidemic and endemic diseases, and from the suppression of tribal warfare and other forms of communal disorder. These advances, notably the benefits of a lower death rate and of the longer life expectation, are ignored in discussions which are conducted solely in terms of per capita figures. Yet the position of those who have failed to die has certainly improved; and so has the position of those whose children continue to live. It is a fact that people like going on living and they are prepared to pay for the satisfaction of the postponement of their own or the death of their children. Reliance solely on per capita income figures implies a criterion of economic advance which registers the birth of a calf or the survival of a cow as signs of economic progress, but the birth of a child or the survival of a person as signs of economic retrogression. The position is essentially that there has been an increase in total output, some of which has been taken out in the form of larger numbers. However, besides the increase in total output there was in almost all these areas also a substantial increase in production and consumption per head as is clear from statistics of agricultural output, from exports, from industrial production, from foreign trade figures, from revenue returns, and from other easily accessible information.

Thus the simplest facts both of economic his-

tory and of the present position of the underdeveloped world overwhelmingly refute the thesis of the vicious circle of poverty and stagnation which is the keystone of the current orthodoxy. The level of income in underdeveloped countries is by definition low, but this is compatible with even rapid advance if that advance has begun only comparatively recently, and has started from a very low level. This is the position in many underdeveloped countries. The thesis of the vicious circle of poverty identifies a low level of income with stagnation. This is a confusion between a low level of economic attainment and a zero rate of change. This is a simple error in logic; and as we have seen the conclusion is also refuted by easily observable empirical evidence both of economic history and of contemporary scene.

Some exponents of the dominant ideas recognise, though somewhat reluctantly, the presence of advanced and advancing (often rapidly advancing) countries, regions and sectors in the under-developed world. These advancing sectors are referred to in their writings as enclaves carved out of the local economy by the advanced countries which do not serve to improve the economic position or prospects of the local population, nor can they serve as basis for further economic progress. This is misleading. First, in many instances the progressive sectors are largely or entirely owned and operated by members of the local population. For instance, all West African agricultural exports, including such world staples as cocoa, groundnuts and oil-palm products, are produced entirely by Africans

on their own lands, and the same applies to the bulk of South-East Asian and South American exports, including rubber, often classified as a European plantation crop; in fact over three-fifths is derived from Asian-owned properties. In all these areas the local population also has a large share in the transport, distribution and simple processing of these exports, and in the distribution of imports. This also applies to industrial activity in many underdeveloped countries, whether for local use or for export. For instance, there are appreciable exports of manufactures from India, Hong Kong and Puerto Rico, very largely the products of enterprises owned and operated by the local population. But even when the enterprises in the advanced sectors are foreign, they usually still assist development by contributing to government revenues, by spreading skills, and generally by promoting the exchange economy.

These are not enclaves cut off from the rest of the economy, but focal points, the points of first impact, of development which always affects certain activities and regions first, from which it subsequently spreads to the rest of the economy. The time this requires depends, among other factors, on the qualities of the population, on institutional factors and on physical communications. There is nothing unusual or abnormal in the uneven regional or sectoral incidence of economic progress.

Reference to the advancing regions and sectors (at times even to entire countries) as enclaves has now become general in the literature on underdeveloped countries. The appeal of this catch-

phrase stems in part from the spurious reconciliation it offers between the manifest evidence of progress in many underdeveloped countries, and the thesis of the vicious circle of poverty, which is both the corner-stone of the current literature on development and the basis of drastic proposals for policy.

I should like to make a point here in order to prevent misunderstanding, and to forestall a possible objection. The argument that the vicious circle of poverty is an untenable thesis should not be mistaken for a plea for *laissez faire* or any other particular policy. For instance, rapid but uneven advance can also pose very great problems and can set difficult, complex and delicate task of Government policy. But these problems are quite different from those of stagnation and would call for very different types of official actions. The development which has taken place throughout the underdeveloped world is amply sufficient to dispose of the suggestion that these countries stagnate or are otherwise caught in a vicious circle of poverty. Nor would I like my remarks to be interpreted as evidence of complacency, as suggestions that all is for the best in the underdeveloped world. I am extremely conscious of the great material poverty of large parts if not most of the underdeveloped world and of the urgent need to relieve it. But fundamentally defective ideas are unlikely to serve as a suitable basis for sane and effective economic policy.

Before leaving the vicious circle of poverty, I would like to examine briefly a particular variant

of this thesis which has lately become very influential in India where it may have been partly responsible for the ready acceptance of the proposal for an expenditure tax. This is the so-called international demonstration effect, which has been advanced by Prof. Nurkse who suggests in his book on Problems of Capital Formation in *Underdeveloped* Countries that contact with advanced economies is often harmful to underdeveloped countries, because it discourages saving and prevents investment. To quote Prof. Nurkse:

> "Knowledge of or contact with new consumption patterns open one's eyes to previously unrecognised possibilities. . . . In the poorer countries such goods are often imported goods, not produced at home; but that is not the only trouble. The basic trouble is that the presence or the mere knowledge of new goods and new methods of consumption tends to raise the general propensity to consume. . . . The vicious circle that keeps down the domestic supply of capital in low-income areas is bad enough by itself. My point is that it tends to be made even worse by the stresses that arise from relative as distinct from absolute poverty. How much worse is a question that cannot be precisely determined; it is a matter of judgment and one that presumably varies from country to country."

This hypothesis suggests that international contacts may serve as a further obstacle to capital formation and economic development, thus, in a sense, substituting another vicious circle of poverty

and stagnation if somehow the first vicious circle has been broken. Prof. Nurkse's formulation is, however, cautious and he notes that the operation of this effect and its applicability to different countries are matters of judgment. However, it is the unqualified version of this hypothesis which has come to be most widely quoted. The international demonstration effect has come to be regarded as a major element in the vicious circle of poverty as well as a ground for blaming richer countries for the poverty of the under-developed world and thus as justification of insisting on income and capital transfers from richer to poorer countries. The international demonstration effect is also invoked in support of far-reaching measures of policy, notably measures designed to restrict or sever international economic contacts, or special taxation of imported consumer goods.

In fact, the results of international contacts are generally precisely the opposite of those assumed by the international demonstration effect. Such contacts generally accelerate economic development in the less developed countries and regions by suggesting new wants, new crops and improved methods generally.' This is well-known from economic history. At present, throughout the underdeveloped world, the more advanced sectors and areas are those in contact with the more developed countries and the most backward are those which have no such contacts. This is clear in India as well: witness the comparison of Bombay or Calcutta's industrial regions with the outlying areas of Uttar Pradesh or Kashmir and similar regions.

It is worth examining the international demonstration effect more closely. In effect it omits to note that the new types of consumer goods brought to the notice of the population can be bought only if incomes are first earned to buy them; and that the desire for a higher and more varied consumption can stimulate saving and investment to satisfy the new wants. Indeed, until quite recently the absence of new wants and the inelasticity of consumption and the rigidity of established habits used to be regarded as major obstacles to economic development. Investment is very generally necessary to make possible production for sale, and this invariably so if subsistence cultivation is replaced by production for exchange. In these circumstances, the dkmonstration effect induces a higher economic performance; this performance is reinforced when the contacts also acquaint the population with new crops and methods of production, the adoption of which makes possible the satisfaction of new wants. You can observe this in many parts of the underdeveloped world. In East Africa, Indian traders bring bicycles, textiles and hardware to the notice of the African population which has never thought of these articles. In order to purchase these goods the Africans then produce cotton and coffee for sale. This process has been a major factor in the spread of the exchange economy in Uganda. In West Africa the Lebanese have played a similar role. In South-East Asia the activities of the Chinese in bringing hardware, textiles and other articles to the notice of the population in up-country Malaya, Thailand, Sumatra and Borneo has been a major factor in the spread of rubber production and in

the agricultural capital formation associated with it. Moreover, by generating cash incomes this process promotes investment also in other parts of the economy besides the sectors first affected by them. Public investment made possible by increased government revenues is a familiar example. The usual exposition of the international demonstration effect seems to assume that the exchange economy has already permeated the entire economy, or at any rate that the expansion of the exchange sector is unaffected by consumption prospects, and more generally by the attractiveness of that sector. These are the assumptions manifestly inapplicable to most underdeveloped countries including India, over a large part of which subsistence cultivation is still predominant and where development of production for sale is a major requisite of economic development.

The recognition of the importance of the expansion of the exchange economy as a factor in economic development, and of the attractiveness of that sector as a factor influencing its expansion, has important implications for policy. For example, if import restrictions greatly curtail the supply of consumer goods which serve as incentive goods which induce people to produce for exchange, their imposition may discourage the development of production for sale, including the production of export commodities or import substitutes (including food). Thus such measures may worsen and not improve the balance of payments, besides retarding economic development. These effects are implicitly recognised in the traditional terminology which refers to

these consumer goods as inducement or incentive goods. Yet these aspects and implications of import restrictions and of consumption taxes seem to be almost wholly ignored in public discussion in India.

There is one sphere of economic life where the international demonstration effect does indeed seem to apply and to result in economic waste. Governments, politicians, and government officials seem to be affected by it, in that they often propose and adopt technical and social standards which are inappropriate and wasteful in the circumstances of their countries. The same applies to the attraction of conspicuous and spectacular investment undertaken in an attempt to imitate technical achievements of other countries. This sort of conspicuous expenditure is not limited neither to public authorities nor to underdeveloped countries. But it has been prominent in government spending in many under-developed countries including, I believe, India. Apart, however, from this important exception, the international demonstration effect is hardly a significant factor obstructing capital formation in under-developed countries. Indeed, as I have already suggested, in the private sector it is much more likely to promote rather than to retard capital formation.

In the economic advance which has taken place in many under-developed countries, agricultural production for sale, that is the production of cash crops, has played an important part. The same applies to the economic history of more highly developed countries. Production of cash crops is generally accompanied by the establishment, exten-

sion, and improvement of agricultural properties, that is by fixed capital formation in agriculture. This important aspect of the economic landscape has been much neglected in contemporary literature, in which significant categories of capital and capital formation are often ignored. Cultivated agricultural properties and their extension and improvement are the most important of these neglected categories; others are live-stock, various types of equipment, simple structures, and, in a related field, traders' stocks.

In underdeveloped countries, agriculture and its ancillary activities are a large proportion of economic activity. Whether they are used for the production of subsistence crops or cash crops, cultivated agricultural properties are income-yielding assets, the productivity of which exceeds that of unimproved land as a result of the expenditure of human effort and activity; and the process of establishing, extending, and improving the land is investment. To disregard it amounts to neglecting all direct agricultural investment in the non-monetary sector of the economy, as well as much of it in the monetary sector (when the land is used for the production of cash crops). These incomplete estimates of investment, that is, estimates which referred only to part of total investment, are often related to the total population or to the total national income which is misleading. These neglected categories are also qualitatively important in the sense that they play an important part in the development from subsistence production to a market economy.

The neglect of these types of investment especially of fixed capital formation in agriculture often results in anomalies. Thus the expenditure of over *S35* million on the East African groundnut scheme is treated as investment and included in the gross investment of the sterling area, even though it has not yielded any groundnuts. At the same time the establishment and improvement of hundreds of thousands of agricultural properties in both West and East Africa, which produce millions of tons of groundnuts, is generally ignored in discussions and estimates of capital formation. Thus an expenditure which has not produced any groundnuts is regarded as part of gross capital formation, but the establishment of holdings which yield a huge tonnage of groundnuts is not so treated.

The presence and significance of investment of agriculture are relevant to a wide range of issues in development policy. They again refute the suggestion of a vicious circle of poverty for they represent substantial capital formation brought about with comparatively small money expenditure. These types of capital and capital formation are also relevant to the rational framing of taxation and of public expenditure, because these cannot be arranged rationally unless the repercussions both of the collection and of the expenditure of funds on these types of capital formation are firmly borne in mind.

Recognition of the presence of fixed capital formation in agriculture also refutes the belief in the allegedly inherent economic short-sightedness of the indigenous population of underdeveloped

countries. This is an important practical point. Much of this investment is in the establishment of small properties of tree or bush crops such as rubber, cocoa, tea and coffee, which are not indigenous in the most important producing regions into which they were introduced comparatively recently. These are products of trees or bushes which do not bear until they are about four to six years old. There are certainly well over five million acres under rubber smallholdings in South-East Asia, while the area under cocoa in Nigeria and Ghana alone exceeds two million acres. Rubber and cocoa trees do not come into bearing until five or more years after planting. Therefore, every Malay or African who plants such trees is capable of looking forward at least five years. This simple evidence conclusively refutes the widespread opinion, which often serves as justification for drastic policies, that the populations of these territories are incapable of taking a long view in economic affairs. It is quite true that the African or Asian population does not readily undertake industrial or large-scale transport or trading-enterprises for the simple reason that such activities are not suitable to their circumstances. But it is abundantly clear from the readiness with which the Africans and Asians plant tree crops that they can take a long view in economic affairs.

The substantial investment in agriculture and the recent progress in many underdeveloped countries and the earlier history of the developed nations also bear on the question of the role of social overhead capital, or infra-structure as it is sometimes

called in economic development. This infra-structure consists of such installations as ports, railways, roads, which do not produce commodities directly but promote economic activity generally. The absence of this infra-structure in underdeveloped countries is supposed to present a particularly intractable obstacle to economic progress because without these installations economic advance is said to be impossible, while the high cost puts them beyond the means of poor countries, and at the same time the economic return is either too long delayed or too general or indiscriminate for private financing. However, the governments of the under-developed countries could borrow from private sources and service the loans from increased revenues, which is indeed what has happened in many underdeveloped countries in the comparatively recent past. In other instances there were certain natural facilities such *as* good harbours or navigable rivers, and the other facilities developed simultaneously with the expansion of economic activity and out of the revenues yielded by it. This, for example, has been the process in Malaya, where at the beginning of the century there were hardly any roads and only modest port facilities, while today there are thousands of miles of metalled roads and up-to-date port facilities.

The infra-structure of reasonably highly developed economies represents massive amounts of capital, and its construction absorbed a large part of total investment over decades or even centuries. Proposals for foreign aid often suggest that this aid, is required "only" for the erection of the necessary

infra-structure (which, in these discussions sometimes includes even certain types of manufacturing industry, especially the production of capital goods), and that its provision will create conditions for development based on private investment from external and internal sources. In fact, the construction of infra-structure of a developed economy is very expensive; but, fortunately, it is not a pre-condition of economic advance. The suggestion that a ready-made infra-structure is necessary for development ignores that this is usually developed in the course of economic advance; it is an example of an unhistorical and unrealistic attitude to the process of economic development. These discussions imply that God has somehow created developed countries with a readymade infra-structure, while the under-developed countries have not been thus provided. Nowadays the problem of financing the infra-structure has been made more difficult by various factors, such as the poor record of many under-developed countries in the treatment of foreign capital, or a diversion of resources into subsidised manufactures or various spectacular investment schemes which reduces the funds available for the construction and maintenance of the social overhead. But these factors are rarely mentioned in current discussion.

I now turn to another topic which plays an important part in public discussion and policy in India. This is the role of manufacturing industry as an instrument of economic advance and the role of the government in promoting manufacturing; industry.

In many contemporary discussions, especially in India and Latin America, Government sponsored industrialisation is widely regarded as the key to economic development and to the improvement of standards of living. Unfortunately, once again, much of the discussion is confused by an irrational attitude by which manufacturing industry is regarded as the cure-all for stagnation and poverty. In fact, manufacturing industry is simply one type of economic activity, and there is no inherent reason why this activity rather than some other activity should at any given time promote either the most efficient allocation of resources or their most rapid growth.

There are many highly developed areas of the world which are primarily agricultural in North America, Western Europe and Australia; and most regions which are now industrialised had reached high levels of development at earlier stages of their history when they were still largely agricultural.

I cannot here discuss all the arguments advanced in support of accelerated industrialisation. But I want to refer to a few of the most popular themes, especially those which are prominent in Indian discussion.

It is often said that the greater relative importance of manufacturing industry in the developed compared to the under-developed countries is evidence that manufacturing industry is a key instrument of economic development. Moreover, within under-developed countries income per head in the manufacturing sector is usually higher than in the agricultural sector, and this is also advanced in

support of the proposition that industrialisation promotes the development of higher incomes.

But this is misleading. It cannot be inferred from the higher level of real income in the more industrialised countries or sectors that their advantage stem from industrialisation. It is quite possible, and is often obviously the case, that the higher level of real income and the higher degree of industrialisation are both results of the same set of causes or influences, such as the possession of, or access to, cheap sources of power, rich mineral ores or some other natural resource, or of accumulated capital, skill, technical or managerial ability. In such circumstances, the extent of manufacturing activity cannot be regarded as the cause of a high level of real income. In these circumstances both the high level of real income and the level of manufacturing activity are both effects of some other cause, viz., the access to, or possession of, valuable resources. This is an example of an important general consideration; a statistical association does not necessarily denote a cause and effect relationship. For instance, it is also true that in developed countries there are generally more hairdressers per thousand of population than in under_ developed countries, but it has not yet been suggested that the best way to promote development would be to increase the number of hairdressers. Yet this would be just as logical as the advocacy of industrialisation on the basis of the statistical relationship between manufacturing industry and a high level of real income. It is absurd to judge the needs of an economy in a particular stage of

development and with a particular collection of resources by reference to some of the characteristics of far wealthier, different and more advanced economies. A situation in which manufacturing is comparatively unimportant may be an inevitable stage in economic development and may represent the most efficient use of resources at that stage.

As a matter of fact, the statistical relationship between manufacturing industry and real income is not simple as is often suggested. For instance, in the United States only about a quarter of the occupied population is in manufacturing industry, a far smaller proportion than in the United Kingdom; yet real income per head in the United States is appreciably higher than in the United Kingdom. The United States, Canada, New Zealand and Sweden all have a much larger proportion of their population in agriculture than the United Kingdom, and yet their real income is much higher. In the United States it was not until towards the end of the nineteenth century that manufacturing industry became generally prominent in the economy; and not until 1910 did the size of the labour force employed in agriculture cease to increase. And it is especially noteworthy in this context that not until 1941 did manufacturing employment exceed agricultural employment in the United States, by which time it had for many decades been the richest or one of the richest countries in the world.

Another line of argument for accelerated industrialisation is based on the necessity of the growth of manufacturing industry to absorb the surplus population on the land and put it to productive

work. This argument is not so crude as the one I have just discussed, and it is to some extent more acceptable. But again it is quite inconclusive. The distinction between cultivable and uncultivable land is not as clear as is often implied. Estimates of cultivable lands are largely arbitrary, and land classified as uncultivable is often cultivable even with existing techniques. Moreover, land which is classed as uncultivable in particular conditions can often be brought into cultivation with changes in technology or government policy, or with the expenditure of capital. Even in India, which is often instanced as a country in which there is no remaining land suitable for cultivation, there are extensive areas described as cultivable waste which, in the opinion of many people, would be suitable for cultivation with modest capital expenditures Thus it is possible that the surplus rural population could be absorbed more profitably and with less expenditure of capital in the extension of agriculture than in the establishment of new industries.

Another argument in favour of accelerated industrialisation suggests that because at higher income levels an increasing proportion of income is usually spent by the people on non-agricultural products, development necessitates an increase in the proportion of people in non-agricultural activities especially in manufacturing industry. But this again is not a clear-cut idea. It is often easier for a country to procure for itself manufactured goods by specialising on agriculture for exports. This is compatible with a very high standard of living, as is clear from the experience of large parts of the

United States, Canada, New Zealand, Australia, Denmark and many other countries. The possibilities of profitable and productive specialisation and exchange are as real for a country as for a region, a district or, for that matter, any other group of persons; and its opportunities are obviously present internationally as well as within a country.

This conclusion is reinforced by another important consideration which is based on somewhat technical reasoning which will, however, be readily intelligible to those of you trained in formal economics. Even within a closed system the prospective pattern of economic activity cannot be inferred from the simple proposition that the income elasticity of demand for industrial products is higher than that for the products of agriculture. When applied to the whole economy, the concept of the income elasticity of demand raises problems of aggregation which affect any general proposition about changes in its average value with economic growth; and this applies particularly when relative factor prices and the distribution of incomes change. The proportion of the total national income spent on agricultural products is necessarily the average of the proportions of income spent by each member of the population as a whole. Even if the income elasticity of demand for these products of every member of the population is less than unity (which is by no means necessarily the case), so that each individual spends a smaller proportion of his income on these products as his income increases, the average proportion of income spent on these products may still increase if most of the increase in the national

income accrues to people whose relative expenditure on these products is above the national average. Such a result is a likely contingency in underdeveloped countries where the income elasticity of demand for many of these products is still generally high. There is no ground for assuming a unique relation between changes in national income and changes in the average expenditure on agricultural products; still less between changes in the national income and the proportions of the population in agricultural and industrial occupations.

There are two further arguments for large-scale industrialisation often heard in contemporary discussion and which have been put to me by members of the audience at lectures which I gave in India and Pakistan. According to one argument, rapid and accelerated development of manufacturing industry is necessary because primary producers somehow face inherently deteriorating terms of trade; and this suggestion is sometimes supported by reference to an alleged deterioration in the terms of trade of primary producers from the 1870's to the 1930's. I find it hard to make sense of this opinion, and I want to mention only the most obvious objections. The statistics usually quoted are almost wholly emptied of significance by the fact of fundamental changes in the conditions of production over these periods, such as the shift in rubber production from that of a South American wild crop to that of an eastern plantation crop. In the 1870's the small amount of rubber exported was collected from jungle trees standing perhaps [illegible] two trees to the acre in the dense forest. At pre-

sent rubber production takes place on estates and small holdings with a hundred or more trees to the acre in easily accessible areas. This is only one example showing the meaningless nature of the statistics usually quoted, which are quite unrelated to factorial terms of trade. But even if the factorial terms of trade had deteriorated, it would not follow that this would continue in the future (in fact, of course, the movement has been quite different during the last twenty years); but even if it did, it still would not follow that other types of activity would yield more favourable results.

The last argument I want to consider suggests that Government assistance to industry is necessary because of the absence in countries such as India and Pakistan of common facilities such as developed transport and financial systems and a tradition of industrial skill which in developed countries are enjoyed by industrial enterprises. These advantages are sometimes known as external economies, and their absence in underdeveloped countries is often urged as an argument for Government support of manufacturing industry. However, while the absence of external economies is a very real disadvantage, the argument based on it is quite unconvincing. It simply expresses the fact that the economy is not highly developed. But this does not imply that particular industries or types of activities should be assisted. Government assistance involves the transfer of resources from other sectors of the economy. One sector is promoted at the expense of another sector and there is no general argument or presumption that this yields exter-

nal economies or in some other way promotes economic development. The argument implies that the sponsored or assisted activity represents *an* equivalent net addition to activity regardless of alternative uses of resources, but it is of the essence of the problem that a transfer of resources is involved. External economies may be made in this particular direction, but other activities contract and external economies are lost there, so that the recognition of the importance of external economies does not offer a general presumption in favour of assisted industrialisation.

In a sense, unfavourable comparisons with manufacturing are generally irrelevant to policy discussions. This is because agricultural production for the market promotes industrialisation, and may indeed be necessary for it, by providing food for the industrial population or by generating cash incomes and thus a market for manufactures, as well as a source of public revenue, which in turn makes possible the production of essential Government services and public investment. The extension of the production of cash crops also serves to acquaint the population with the ways of a money economy and present opportunities and scope for the activities of those endowed with entrepreneurial and administrative talents. When many peo-[illegible] have become used to the working of an exchange economy, and when latent entrepreneurial and administrative talents have had time to develop, the additional technical skills necessary for manufacturing can then be acquired more readily than is possible without these advantages. Moreover, deve-

lopment by means of the growth of agricultural production for sale represents less of a break with customary methods of production and existence than the development of manufacturing industry at an early stage, and therefore reliance on it minimises the difficulties of adjustment often present in rapid economic development and thus ease the social and political tensions involved. . The rapid promotion of manufacturing industry in an economy which has only recently emerged from the subsistence stage is likely to involve greater social and political tensions than progress from subsistence production to agricultural production for exchange and then to industrial production.

Thus the promotion of economic and efficient industrialisation is much more complicated than is implied in the somewhat crude arguments usually encountered in this realm of discussion. Quite possibly, the best way for Government to foster industrialisation (especially industrialisation which is economic in terms both of the allocation and the growth of resources), may be for it to use more rather than less of its resources to encourage the enlargement of agricultural output and the improvement of agricultural techniques. This may be found paradoxical at first, but on reflection it is really basically quite simple, when it is recognised that the most efficient allocation of national resources is most likely to promote the development of manufacturing industry. No generalisation is possible in view of the diversity of conditions in under-developed countries, and even within a single country such as India, and in view of the differences in the

level of development attained in different regions. However, it may be suggested with some confidence that in the earliest stages of development suitable assistance to agriculture may be the best safeguard for the establishment and growth of a viable industrial sector, and it can also be said with confidence that the promotion of any uneconomic activity retards the development of economic activity, including efficient and economic branches of manufacturing industry.

But while there is no special merit in manufacturing industry as an instrument of development because manufacturing is but one type of economic activity, it is also incorrect to suggest that without large-scale government assistance, that is without subsidisation at the expense of the rest of the economy, there would be no industrialisation. This suggestion is refuted both by the history of the developed world, and also by contemporary experience of underdeveloped countries. In this connection the rapid growth of manufacturing in Hong Kong is of much interest. Hong Kong has practically no raw materials, nor fuel, nor hydro-electric power, and only a very restricted domestic market. In spite of these limitations, which are frequent' alleged to be crippling to unsubsidised in[illegible] [illegible]nal development in underdeveloped countr[illegible], manufacturing industry in Hong Kong has progressed phenomenally in recent years without any subsidy. It has developed much more rapidly than it has in the other Asian countries where manufacturing industries are usually heavily subsidised. In 1940 there were 800 registered factories in Hong Kong; by now there are over 3,000 employing about 1,30,000 workers. But counting the self-employed and the much larger numbers employed by unregistered factories, there are probably over 400,000 people in manufacturing in a total population of less than three million. The total output of manufactures in Hong Kong is about £100 million a year, about half of which is exported, mostly textiles, food, drink, tobacco products, rubber and leather ware, electrical products, light engineering products and hardware. About one-half of exports 'are to non-British territories, where they enjoy no preferential treatment whatever; and apart from the competition in export markets, imports from Hong Kong into the U.K. have become a serious embarrassment to British manufacturers. Official measures are now under consideration to protect the British home market from imports of unsubsidised manufactures from Hong Kong, an underdeveloped country 8,000 miles away.

The problems and merits of government action in the provision of social over-head capital or in accelerating industrialisation have been prominent in the discussions of economic policy for many years. Of more recent origin, are the very influential arguments, prominent in Indian discussions on economic planning, that large-scale socialisation of the economy is indispensable for the promotion of economic development in underdeveloped countries. It is now suggested that the vicious circle of poverty and stagnation as exemplified by the low level of incomes is evidence of failure of private initiative and of market forces and thus of the need

for extensive socialisation. For instance, Dr. Gunnar Myrdal writes in Development *and Under-development*:

> "Apparently nobody in the advanced countries sees any other way out of the difficulties, which are mounting in the under-developed countries, than the socialistic one, however differently one's attitude may be towards the economic problems at home."

Nor is this merely academic advocacy, but is also widely accepted basis for policy in the under-developed world including India. Thus, according to the Draft Plan-Frame, the first objective of the Second Five-Year Plan is:

> "(1) to attain a rapid growth of the national economy by increasing the scope and importance of the public sector and in this way to advance to a socialistic pattern of society."

In assessing the suggestion, it is important first to remember that the low level of income is not, synonymous with stagnation, but in fact is consistent with rapid growth of economic development. I have already noted that a low level is consistent with rapid growth if that growth has started only recently from a very low level. It is important to remember the difference between a level and a rate of change. Further, it is entirely meaningless to ascribe poverty or stagnation to failure of private enterprise, rather than to unsuitable social and political institutions or to unfavourable economic attitude or qualities of the population, or to lack of resources. For instance, social and religious factors

are obviously of major importance in the material poverty of India, and it only confuses the issue to regard this poverty as evidence of the failure of private enterprise. More generally, there is no prescriptive right of development ensuring that all communities should reach the same level of income or rate of development at any given time, or should be caught up simultaneously in the stream of material progress. There is nothing abnormal in differences in these respects, nor does the presence of these differences in ecsnomic attainment imply that they will be permanent.

In this context it is often said, both in the under-developed world at large and especially in India, that because of the lack of entrepreneurial ability in these countries, the government has to take over functions which elsewhere can be left to private enterprise. There are three links in this chain of reasoning. First of all it suggests that poverty is evidence of stagnation, and secondly that poverty is evidence of the failure of private enterprise. I have already discussed both these arguments. The third link in the chain is the suggestion that poverty is evidence of a lack of constructive entrepreneurship so that it becomes necessary for the government to undertake entrepreneurial functions which elsewhere can be left to private enterprise. Unfortunately, it is rarely made clear from where the government will obtain the supply of entrepreneurial talent if there is none in the economy.

While the vicious circle of poverty and the failure of private enterprise are the twin intellec-

tual bases of the arguments of the most influential school of thought in this realm of discussion in India, as elsewhere, the principal conclusions are that comprehensive development planning and compulsory saving are necessary for economic develop ment. Comprehensive development planning, in other words governmental determination of the composition and the direction of economic activity, is deemed necessary to divert activity into what are called "socially desirable" directions, as distinct from those into which the decisions of individual producers and consumers would direct them. This is regarded as indispensable for economic progress.

Unfortunately again the advocates of comprehensive development planning simply assume that this re-arrangement of resources aacelerates economic progress without explaining how this comes about. For instance, Dr. Myrdal writes in his book Development and Under-development:

> "The national plans cannot be made in terms of costs and profits for the individual enterprises; they can, in fact, not be made in terms of the prices of the markets . . . the whole meaning of the national plan is to give such shelter from market forces to investment, enterprise and production that they become undertaken in spite of the fact that they are not remunerative according to private business calculations.
>
> "It is here that the national state comes in as representing the common and long-term interests of the community at large. It senses the fictitiousness of the private business calculations in terms of costs and profits."

This certainly does not show how the economy is to benefit from the overriding of the decisions of the individuals comprising it. It simply assumes that whatever the state does, represents the true long-term national interest.

The discussion of this range of issues has been much obscured by regarding the sectors, activities or enterprises sponsored by the Plan as equivalent net additions to output or activity regardless of the alternative uses of the resources involved. Yet, quite clearly, the whole process cannot be assessed rationally unless it is recognized that what is involved is the reallocation of resources, and it needs to be shown why this rather than some other use of resources accelerates the growth of output and the rise of living standards.

Within the general framework of comprehensive development planning, proposals for compulsory saving are especially prominent. This is familiar to you from the current Indian literature. Compulsory saving means special taxation designed to accelerate investment expenditure, usually by the Government, apart from the taxation required to finance public investment necessary for the essential Governmental functions. It is often regarded as axiomatic that compulsory saving is necessary to increase output in underdeveloped countries, and further that this increase in output is desirable. However, these conclusions are not obvious.

First, there has been a rapid economic development in many parts of the world without com-

pulsory saving. This is true both of the earlier history of the developed countries, and of the more recent history of many underdeveloped countries. Therefore, compulsory saving is in no way indispensable for economic development. Second, compulsory saving does not necessarily increase either the total supply of capital or total output. It is a transfer of funds from the private to the public sector, and its contribution to the supply of capital is a net factor, after allowing for the repercussions on private capital formation of both the collection and the expenditure of the funds. Very generally, this net contribution is less than the total proceeds of compulsory saving because of the diminished capital formation in the private sector. It may even be negative if the contraction of capital formation in the private sector exceeds the proceeds of compulsory saving, which is by no means impossible, especially when the process retards the expansion of the exchange economy, that is the progress from subsistence production to production for sale. These considerations are largely ignored in current discussion which often, and indeed usually, regards the proceeds of compulsory saving as an equivalent net addition to capital formation. Yet the process cannot be rationally considered unless it is clearly recognised as a transfer of funds from the private to the public sector. This is not in itself an argument against compulsory saving, but is an essentially relevant consideration for its proper assessment. Moreover, it is relevant not only for the assessment of the economic merits of compulsory saving, but also for its most productive arrangement. For instance, unless the repercussions on the

private sector are recognised, it is not possible to design either taxation or the expenditure of the funds in such a way as to maximise the desired and minimise the undesired effects on the economy as a whole. A policy of compulsory saving cannot be framed rationally unless the repercussions on the private sector of both the collection and the expenditure of 'the funds are recognised.

Let me enlarge on this by means of a specific example taken from West Africa. In Nigeria there are five major export crops, cocoa, groundnuts, palm oil, palm kernels, and cotton. Cocoa, groundnuts and cotton are cultivated products, while palm oil and palm kernels are wild crops, that is, they are collected from naturally occurring jungle trees. There are very heavy export taxes in Nigeria, the proceeds of which are used in part to finance development expenditure. Taxation of the producers of palm oil and palm kernels does not affect the extension of capacity because, as I have just noted, these are not planted crops. The extension of capacity of the other products is, however, much affected by the price received by producers and thus by the level of export taxes. In fact, the producers of palm oil and palm kernels have been taxed relatively lightly compared to the producers of these other export crops. While political factors and chance circumstances have played a part in this distribution of the cost of taxation, neglect of its effects on the extension of capacity has also played a part. Of course, there are other considerations, notably those of equity, which also need to be borne in mind when framing taxation policy. You will readily

recognise that unless the repercussions on the private sector are remembered the policy cannot be rationally and effectively arranged and executed.

Moreover, even if compulsory saving increases the total flow of investible funds this does not necessarily bring about an increase in output. The growth of output is not simply the function of investment expenditure; expenditure does not become productive simply by terming it investment. The facile belief that expenditure termed investment is necessarily productive, and that investment is the essential or even sufficient factor in economic development has been responsible for waste on a colossal scale.

Even if the growth of output is accelerated by compulsory saving, which is not certain, this increase does not necessarily imply desired output, in the sense of goods and services which would have been bought freely by the population. This is because the process increases the proportion of the national output subject to direct governmental control or bought out of taxes, as distinct from output bought on the market by consumers out of freely disposable incomes. Yet if development has a clear meaning as a desirable process, it would seem reasonable that it should refer to desired output, and not simply to any collection of physical goods and services, regardless of consumer demand. And only if the increase in the volume of goods and services represents output desired by people as individuals does it represent a widening of their range of opportunities, of the alternatives open to them as consumers and producers, which is the deeper meaning

of economic development. Professor Arthur Lewis says in his book The Theory of Economic *Growth* that the case for economic development does not rest on the argument that it makes people happy, but that it increases their range of choice. With this I agree profoundly. But if output is increased by the exercise of compulsion this does not imply a widening in peoples' range of choice in the same way as if it has been brought about without such compulsion.

Compulsory saving and comprehensive development planning generally imply far-reaching centralised governmental control over the lives, activities, and sources of livelihood of people, with pervasive social and political results. They imply societies in which there are great inequalities of power, in that some individuals and groups have far-reaching powers over others, whose access to alternatives in both the earning and spending of their incomes is greatly restricted. The great increase in the prizes of political power which stems from these measures, enhances the intensity of the political struggle in under-developed countries, which is particularly manifest in plural, multi-racial societies. One reason why the political struggle is so intense at present in many parts of the under-developed world is that so much is at stake, because the government controls peoples' lives so closely. Such pervasive and far-reaching policies as comprehensive development planning and compulsory saving must be judged largely on the basis of a political position, and only in part on technical economic reasoning. Their assessment depends very largely on what

kind of society you prefer, which is not a technical economic matter. But at both levels, that is on a political level and on technical economic reasoning, it is relevant to remember that such policies are not generally indispensable for economic development, that they may not increase output, let alone desired output, and also that there has been much development in both the developed and the under-developed world without such policies. Indeed, not one of the now highly developed countries had to resort to these methods in the earlier stages of their development. It is only in the Soviet economies that comprehensive development planning and compulsory saving have been adopted as the central instrument of economic advance, and the characteristics of these societies reflect the progressive nature of these policies.

Let me now sum up. The under-developed countries which comprise over two-thirds of the world represent a vast aggregate, much more diverse than is often realised. The vicious circle of poverty and stagnation which is the keystone and leading theme of current discussion is manifestly invalid as a general proposition. A low level of income does not imply stagnation, and is indeed compatible even with rapid economic advance. Poverty or a slow rate of development are evidence neither of an abnormal situation nor of failure of private initiative. The policies now being proposed by the most influential current school of thought do not ensure an increase in output, and even if they did, this would not necessarily mean economic improvement for the masses. On the other hand,

these proposals have far-reaching and pervasive political and social results, in that they promote societies with great inequality in power in which the lives and activities of the population are closely controlled by the government.

You will probably expect me in conclusion to say something more positive and specific about policies for relieving poverty and accelerating development in under-developed countries, especially India. I am indeed tempted to do so. But I think it would be a mistake to yield to this temptation and to advance specific proposals for policy. I think this for the following reasons. Generalised policy recommendations applicable to the under-developed world as a whole would either have to be so vague as to be uninteresting or, if they were more specific, they would fail to take account of the essential diversity of these countries, and I do not know India sufficiently to propose specific policies. The merits both of particular measures and of more general policies depend on their effects on the total social situation, and not only on those aspects with which economists are primarily concerned. It is also necessary to take into account social, political and administrative possibilities when proposing courses of policy. More fundamentally, policy recommendations are deeply influenced by political positions and value judgments, especially one's view of the kind of society one prefers. For all these reasons, I think it would be inappropriate for me to be drawn into discussion of policy. But I may, perhaps, be permitted to make some bold remarks which bear on development policy in many under-

developed countries including India, even if they do not amount to recommendations for specific policies.

First, there is a wide range of tasks in under-developed countries as elsewhere which necessarily devolve on the government. These include the promotion of a suitable institutional framework for the activity of individuals; the maintenance of law and order; the control of the supply of money; the provision of basic health, and educational services, transport facilities, and of agricultural extension work; and certain other tasks as well. The adequate performance of these functions exceeds the resources of governments of all under-developed countries which I know, even without such ambitious aims as comprehensive development planning and the like. At present we are faced with the paradoxical situation that governments engage in ambitious tasks when they are unable to fulfil even the elementary and necessary functions of government, functions which necessarily devolve on the government because they cannot be undertaken by the private sector.

Some of these necessary tasks are of great importance and complexity, especially the provision and improvement of the institutional framework of economic activity. Institutions suitable for the efficient operation of the economic system do not necessarily emerge from the operation of the system itself. The economic endeavour of people is likely to be frustrated unless the institutional structure is suitable for the efficient performance of their tasks, and is moreover continuously adapted to changing needs. For instance, the market cannot be expected to bring about a suitable law of property, or institutions such as that of limited liability. In the early stages of economic advance, notably in the development from subsistence to a market economy, the development of a suitable institutional framework poses formidable difficulties. The provision of such a framework necessarily devolves on the government as the executive organ of the community. Similarly, expenditure yielding benefits indiscriminately devolve largely on the government because the individuals benefitting cannot be made to pay directly for these services. The provision of national defence, justice, basic transport and other facilities are familiar examples.

Secondly, I want to remind you again that if development is to be meaningful as a desirable aim of policy it cannot refer simply to the growth of output of physical commodities unrelated to the wants of individuals comprising the society. I realise that this involves a value judgment. This value judgment is the attachment of meaning and significance to individual valuations and desires. There are many people, including prominent figures in India, who think that individual valuations are meaningless. Accordingly they are prepared to disregard such valuations in discussions of the process of economic development. I reject such an approach. But I recognise that this rejection stems from a political position and not from technical economic reasoning.

Third, the rapid development in recent years of many under-developed countries shows that the forces which promoted progress in the early history

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of the developed countries are often present in under-developed countries, unless obstructed by specially unfavourable social arrangements or political measures.

You will see from these few remarks that I envisage extensive governmental functions in under-developed countries, the adequate performance of which poses formidable problems. It is regrettable that so much of current discussion obscures rather than elucidates many of these problems and thus makes their solution more and not less difficult.

Much of what I have said to you runs counter to the most influential current ideas on the subject. If I am shown to be wrong, I shall have to reconsider these arguments. But the fact that they are politically unpopular has no bearing on their validity. I will close by quoting some remarks of Alfred Marshall which should be borne in mind both by those who are engaged in the study of under-developed countries, and by those who wish to influence policy.

> "While taking an attitude of reserve towards movements that are already popular, you will incline to be critical of prophecies that are fashionable."

And he also realised the results of such an attitude:

> "Students of social science must fear popular approval; evil is with them, when all men speak well of them. . . . It is almost impossible for a student to be a true patriot and have the reputation of being one at the same time."

* * * *

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"Free Enterprise was born with man and shall survive as long as man survives."

—A. D. Shroff

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