Interference of Some Unrecognized Assumptions on Economic Development

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Abstract :

This working paper attempts to look behind and beyond the various formal assumptions, e. g., the surplus labor theory and the limitations of traditional values, which formed the basis of the economic development agenda pursued the world over for the last five decades. There were some assumptions made then that were not recognized as such. Unfortunately, their ramifications have not been benign or beneficial. So, it is critical to identify them and understand their role in the general failure of this much-flaunted agenda. Perhaps this clarification will allow for a more efficient route to economic development in the future.

Introduction

Economic development has been a long and arduous process for all industrially aspiring countries (IAC's)[1]. Some IAC's started in this journey almost fifty years ago[2]. Now, the modern science of Economics as well as new forms of economic development first manifested in the developed west. The IAC's emerged from long periods of colonization and immediately felt the heat of Marxism, economic competition and spiraling population. Incredible amount of debate went on globally about how this process could be transferred to the IAC's. At the same time most IAC governments swung from one dictatorial form to another. The IAC's became awash in military, industrial, health and political aid, to name a few. Soon, the once united and homogenous society became fragmented between haves and have-nots, military and civilian, bureaucrats and ordinary citizen, pushy and docile, crafty and straightforward. While volumes were written and series of economic plans accepted over the years, many critical questions went unasked, many assumptions unexamined. In fact, unfortunately, IAC's are still unaware of those forgotten premises.

This paper attempts to gather those questions or assumptions. Since free market is very much in vogue today, issues of resource endowment, comparative advantage, market failure, missing market, efficient economic empowerment, etc. need to be fully understood. While the west has pushed for free market, strangely enough, it is also responsible for some of the antimarket forces that abound IAC's. The IAC's

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1. I use IAC in place of Less Developing Country (LDC) or Developing Country. I find the latter nomenclature misleading. Why? What does to develop mean? Does it mean to leave old languages, abandon old traditions and values, and give up dress and food habits and old social etiquettes and relationships? The one truth in all this is that all such countries one to industrialize, they do not want to be clones of the west. The IAC descriptor is then very precise and to the point.

2. India -, Pakistan -, Brazil -, Turkey -, South Korea -, Taiwan -, and Sri Lanka.

need to take a page from the manual the west uses to analyze its own economic problems and undertake their own housekeeping. It is expected that this type of analysis will give economists and policy makers from the IAC's some ownership of the intellectual basis of the programs in place or about to be placed in their countries. Heretofore, most important thought processes have been derived from outside the boundaries of the IAC's. In total, six assumptions and three corollaries to the assumptions are examined. They are: Central Planning and Foreign Aid do not harm free market (corollary-Growth driven by a leading sector is inferior to balanced growh), Entrepreneurs are scarcer than investment funds, (corollaries - Economic interest and vision of traders and industrialists are one and the same, and Assist entrepreneurs, sacrifice consumer welfare and infinitum), Literacy can wait, Broad-based university curricula is the answer to human capital shortage, Foreign aid, even for NGO's, is always good, and finally, Economic policies are either absolutely good or absolutely bad.

Assumption I : Central planning plus Foreign Aid regime do not harm free market

In the 1950's, with the advent of central planning and foreign aid a stage was set for effective undermining of free market processes. The thinking was opposite. It was unquestionably expected that the twin forces of property rights and free market efficiency (cost effectiveness) would rapidly mitigate under development. Even today hardly any literature exists on this point. However, it appears that market failure resulted from this approach. That this could transpire easily follows from theory. Central governments endowed with foreign aid bulged with resource far in access of what they would be able to gather based on accrued tax revenue. The rest of the economy lacked a network of banks. The largely rural popultion possessed a high propensity for self-sufficiency in an essentially subsistent economy. The foreign resource transfer, thus, gave the government a totally monopolistic veneer, especially in the money market. However, it used this clout in a counter-intuitive manner. Interest rate on borrowed money was lowered below the market rate while simultaneously introducing rationing of capital to projects according to its choices. The rationing was theoretically justified. Little, if any, empiricism existed then to question these choices. Consequently, de facto, free market was abrogated.

In the 1980's we saw the impact of this planned, market approach to economic development. The Eastern European economics emerged with 90 plus percent literacy rate, universal health care, comprehensive transportation and communication net work, to name a few. Compared to the USA and Western Europe and Japan they were far behind. However, compared to the industrially aspiring countries (IAC's) they stood far ahead. While these countries knowingly undermined free market and property rights, the IAC's did it unknowingly to their great detriment. The East European nations had an agenda to overcome capitalism by planned means. The IAC's had no such agenda. Why should they? They believed in the opposite. They expected that their hybrid method would deliver just as well sector by sector. It did not.

Corollary 1.1: Growth driven by a leading sector is inferior to balanced growth

Growth led by a leading sector is inferior to balance growth. By a leading sector I construe a sector showing both the highest rate of capital flow and rate of return compared to other sectors. This approach appears to have been a blind drive toward egalitarianism ignoring the critical element of comparative advantage. The result has been overall poor to mediocre performance. Now, poverty rather than plenty is shared. This happened even though property rights and free market were recognized. This happened simply because centralized planning and foreign aid availability reduced the same twin principles to shambles.

Assumption 2: Entrepreneurs are scarcer than investment funds

This happened even though property rights and fre market were, recognized. Dual Economic Theory and Surplus Labor Hypothesis dealt with scarcity and redirection of investible surplus. It made cash transfer from the rural (presumably displaying a low saving rate) to the urban sector possible by introducing dual foreign exchange rate, one for export and another for import, and by making industrial products costlier compared to agricultural products. Simultaneously it reduced lending interest rate to facilitate individual investor's demand for cash resource. Finally, it restricted imports so that these investors could function in a protected market. True, limiting their investment choices controlled their investment agenda. However, little concern was shown as to what may happen if they misread the market or misused the fund. Would this waste offset the saving generation goal that motivated the rural-urban transfer? More importantly, the more basic resource related question went begging. Which was scarcer, investment resource or entrepreneurs? The de facto assumption was that the latter was scarcer. By valuing this resource higher the access price to the other resource was reduced. This was a very wrong deduction, completely the opposite of the truth. In fact, in the long run, when the investors failed to deliver in the form of an industrial revolution, the cost to society has been stupefying. Today, the failure to nurture domestic resource buildup has resulted in an almost irreversible dependence on foreign funding.

Corollary 2.1 : Economic interest and vision of traders and industrialists are one and the same

Whether openly stated or not, traders and industrialists cannot have the same economic agenda. One earns by trading, the other by producing. Restrictions on trade hurt the trading sector. To the extent an individual graduates from trader status to industrial investor status, the dissonance may not be major. However, as soon as a dual exchange rate-interest rate-price level policy came into play, the need to be a trader before becoming an industrial investor ceased to be true. Consequently, the schism between these two classes of businessmen became radically wider. It destroyed the natural transition from one class to another that most other developed economies had here-to-fore enjoyed. The traders were less educated and less worldly, while the potential industrialists hobnobbed with bureaucrats, politicians, bankers, and foreign dignitaries and suppliers.

Today in Bangladesh people lament the flooding of her market with foreign products. No doubt it hurts the industrialists. But it is not a surprise that it is happening. The traders are doing what they are supposed to do naturally. So long as they do not deal in social contraband there is perhaps no reason to stop them. Perhaps what the policy makers should be trying to do is to help promote these traders into industrialists instead of promoting people with no business experience to find a product, unearth a production method, promote a market and manage employees while while being propped up with low collateral requrement and low interest rate funding.

Corollary 2.2: Assist entrepreneurs, sacrifice consumer welfare and infinitum

Restriction on import, an act favoring industrial investors, had become a permanent feature of government policy. This of course raises the price to consumers and reduces their welfare. This policy may be justified by pointing to long run vs. short run trade off. Industrial investment creates better jobs. So, ultimately the employees, who are the consumers, will be more empowered to spend. However, there appears not to be any time horizon or deadline as to when this protection will cease to operate.

Assumption 3: Literacy can wait

Literacy is the quietest, cheapest and the most needed form of empowerment. It provides dignity, reduces fear and shame and pushes people one step forward toward selfsufficiency. Information ethical and otherwise is now directly available to them. This is the stepping-stone to true democracy. Discover oil and gas or any other mineral resource and notice how the vultures descend on an economy. The situation is like the proverbial man-eating tiger. Once it has tasted human blood nothing tastes good any more.

Now, in all of the thrust toward economic vitalization nowhere other than in the Communist countries and a handful of free-market economies in South East Asia has an agenda for literacy taken on any steam. It has been a completely ignored sector. It has not even been a sector that was consciously downplayed. That is because it has never been discussed as an urgent development goal. It has hardly kept pace with population growth. The governments wanted industrialization. So they focused on assisting industrialists. The industrialists did not have the time, resource or the goal to invest in the promotion of literacy. They had no manpower shortage. This should have been a publicly guided and invested macroeconomic agenda. Unfortunately, the government had better things to do. Also, it is not clear how much foreign donors pushed on this matter. Because the rate of return was slow and immeasurable donor agencies most likely did not see much merit in such a venture. Balanced growth, indeed!

With respect to literacy, one set of evidence stands out in general. In the mid 1970's, the per capita wealth of a US citizen was $75;000[]. Of that 52 percent or $39,000 constituted human capital, knowledge and skill. No wonder South korea, Taiwan and Japan have had such surge in their per capita incomes and have leapt so close to the US per capita income in real terms since they started their development effort. That is because they, too, have invested in human capital including a sustained drive for literacy. With respect to Bangladesh on this matter one instance stands out. Around 1973/74 the Bangladesh government launched the Qudrat-e-Khuda Commission. Extensive interviews were taken of academicians from of all types of educational institutions. One of the goals, presumably, was to promote literacy. However, whatever the recommendations, they were all shelved. Rumor has it that a literate youth would spawn a strong communist movement, especially if it remained unemployed. The then India was cited as an example over-educated, under-employed youth. Strangely, no country ever became communist because it was too literate. Now, Vietnam's literacy rate is ahead of that of Bangladesh.

Assumption 4: Broad-based university curricula is the answer to human capital shortage

One of the focal points of the balanced growth was to provide broad-based university education. Equal or easy access to vast number of students to higher education is not a bad idea in of itself. However, studying in a university is an act of private and public resource expenditure as well as an act of building hope and raising expectation in terms of employment and income. However, without a corresponding employment scope such ideas were quickly reduced to bloated rhetoric. This resulted in a continuous process of brain drain. Why did that happen? The academic programs were borrowed from the catalogues of universities in the West. But the western curricula reflected their own job market reality. A proper acknowledgment, let alone a proper understanding, of this factor was missing during the time of program and curricula adoption. So, we have a massive global Diaspora of educated disenchanted and disenfranchised individuals. Unconsciously and imperceptibly, the developing economies supplied university graduates to meet the demands of western economies.

Two IAC leaders noticed the failure of university education, China's Chairman Mao-Tse-Tung and Iran's Ayatollah Khomeini. However, they reacted differently. The Chinese leader banned higher education and banished the academicians to alternative vocations. The Iranian Imam, benefiting from the long Islamic tradition favoring knowledge or 'ilm and not basing his opinion on a class-based analysis of events, forced universities to restructure the university programs and curricula to focus on issues within the country. So, the loss, post-1979 revolution, from readjustment of higher education has been largely limited, unlike as in the case of China. Not only that, after a 10 year-long war with Iraq and 20 years of sustained international pariah status Iran has managed to achieve a 80 percent literacy rate. Furthermore, that university programs and curricula modeled after western institutions are mindless copying is proven by a recent development in Bangladesh. Ever since the private university bill was passed in Bangladesh about five years ago, universities have been sprouting in Bangladesh all over the country. These, universities, unlike the public universities, are very narrowly focused. They are only supporting those majors that have employment scope for their students. They have a wide variety of subsidiary subjects for use as minor. In this manner they have ensured their economic viability. It is a terrific example of judicious use of limited resources. That is a far cry from the balanced growth approach that was applied by the public sector for university education.

Assumption 5: Foreign aid, even for NGO's, is always good.

Uponobserving for decades inefficiency and corruption at central government level, donor agencies led by the World Bank have devised an alternative route for channeling funds into IAC's. This has been through non-governmental organizations (NGO's). None to little social and political impact analyses was made before adopting this formula. However, the advent of the Grameen Bank, in the early 1980's, resolved the collateral insolvency issue by forwarding small, revolving, individual loans to mutually monitoring small group. As a result, the donor agencies went though an Archimedes type Eureka experience. They plunged a portion of their monies for rural poverty alleviation via NGO's to such small groups.

While I will skip the long run socio-political impact of this approach, I cannot help but express my anxiety that an unspoken assumption has been made in reaching this decision. That assumption is that the men in IAC's oppress women. This is a post-industrial revolution, post-democracy post 99-percent literacy, and post-hippy generation evolutionary world-view in the western societies. To act on this type of sweeping generalization is very foolhardy given the track record of all failed policies that I have enumerated earlier. Instead of bringing society together, instead of using existing harmony and homogeneity among genders, in spite of the differences, to shape socio-economic policies may generate, not release, forces that heretofore did not exist. It is possible that after a while many problems may no longer be viewed as joint problems, a view that would help consolidate plans and programs for greater impact. The Bangladeshi government must wake up to this possibility and take steps to stem this type of massive international incursion into the fabric of the society while taking note that today's China while enjoying massive direct foreign investment has not been subject to similar incursion.

Finally, one must ask the question whether the NGO's are best suited for poverty alleviation or they are the ideal vehicles for industrial revolution. Given their rural focus, size of individual project funding, demand on collateral, etc, it is easy to see where they belong. They are unlikely to be vanguards of industrial revolution. If that is the case, then the IAC's and donor agencies must acknowledge this feature of the NGO's in a hurry. The reason for this urgency is based on the fact that some NGO's appear to be funding, in fact subsidizing, industrial projects. Thus, they are competing with private banks. Since the monies funneled to the NGO's are different in characteristics from that raised by banks and because the latter is domestic market driven, it is clear that the NGO's must steer clear from the entire industrial sector that banks are naturally slated to serve. They must not be the unspoken competitors of private banks in the IAC's.

Assumption 6; Economic policies are either absolutely good or absolutely bad

Typically, economic policies are judged on efficiency. How much resource, time and otherwise, will be expended on attaining a particular goal by taking one approach and not another? So, assessments will shape opinions whether a policy has identified the correct goal(s) and whether the route suggested by it is the most efficient. In that sense most policiess are neither absolutely good or absolutely bad. Given time, which a steady government may provide, a bad policy will deliver. At that time, all negative points about it are moot. The price has been paid and the goal(s) attained. Since the economy will not have to revisit the same situation which led to the plan in the first place, there is no longer much future value to discussing the pros and cons of the completed policy. Thus, although India's import substitution policy protected by tariffs and promoted through heavy industry buildup was not as efficient as the Taiwanese policy, after 50 years of constancy, it appears to have positioned India on a formidable plane. Thus, economies that constantly fiddle with major macroeconomic policies are going to remain industrially undelivered for a long time.

Conclusion

On the eve of the 21st century, IAC's need to reflect on their economic goals and the free market process that may lead to attaining them. They must be absolutely certain that the transition from the old and failed ways of running their economies to new ways is as complete and water tight as current understanding of economics will allow. On this path lie nine apparently innocuous assumptions and corollaries. Most of them have been in place for decades and have inflicted heavy pain to the IAC's and yet they have never been officially thought of as culprits.This paper focuses on those assumptions and corollaries. While the developed nations pursue the new information age economics, the IAC's must pursue an old information new age economics.