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Changing Perceptions and Realities of Economic Development

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CHANGING PERCEPTIONS AND REALITIES OF ECONOMIC DEVELOPMENT

It is a great honor to give the Zahid Husain Memorial Lecture. My topic today is the ways in which the perceptions and realities of economic development have changed over the four decades of conscious development effort and policy. I shall use the occasion to review what we have learned, and what we are learning about the development process, and how government policy may accelerate or impede development.

As you will see, I shall conclude that one of the key changes in the 1980s has been our increased understanding of the importance of reasonably conservative macroeconomic policy: it is an appropriate memorial to Governor Zahid Husain, as the traditions of Pakistan have included realistic macroeconomic policies since independence. In that regard, Governor Husain's legacy has permitted Pakistan to avoid some of the most difficult problems that are confronting much of the developing world in the 1980s.

The anthropologists teach us that one of the essential features of humanity is that we are problem-solving creatures. As individuals and as societies, we recognize the heaviest constraints on our well-being, and focus our resources on solving or relaxing those constraints. As the crucial problems are solved, or at least reduced in importance, other issues emerge as central to improvement of well-being and attention turns to finding means of relieving their negative impact on welfare. The "Ascent of Man" has been a long process of turning attention to the next item on the agenda (even if it was previously not recognized as next in importance) as earlier issues were resolved.

To be sure, this problem solving activity has to a considerable degree been conditioned by perception of the probability of successfully ameliorating each individual phenomenon. And, as problems have been successfully addressed, their resolution has on frequent occasion resulted in side effects, themselves problematic given society's increased well-being.

An example of this phenomenon may help to understand this "learning", or "problem-solving" behavior better. And, since my theme is that the development community has learned a lot, resolving a large number of problems over that time, while creating other problems that now occupy our attention, it is worth pausing to consider an example from another, but closely related, field of human endeavor. Consider, for example, the concern now exhibited throughout the world for the environment. In every sense, that concern is a legitimate and important one. But, especially in the industrial countries, environmental damage is in large part a result of success with increasing output and living standards. It is arguable that environmental damage was in many regards more harmful a century or more ago than it is at the present time. But success in raising living standards has led to a shift in attention: were the ability to produce goods and services less advanced, it is doubtful that the environment would receive the attention it does. Now, given the availability of increased resources, reducing environmental damage arises as a central concern. Successful problem solving is beginning to reduce environmental stress in many dimensions. As further break-throughs are achieved, attention will undoubtedly shift yet again.

To return to the main theme, the past forty years have been ones of spectacularly successful problem-solving for most of the developing countries. Leaving aside the special and very severe problems of Sub-Saharan Africa (to which the attention of much of the international community is now turning, having reduced the severity of development problems in much of the rest of the world), development has proceeded more rapidly than was thought possible in the 1940s and 1950s. As David Morawetz pointed out in his twenty-five year retrospective, all projections of growth rates made at the time greatly underestimated the average rate of growth that would be attained by developing countries, and even more, greatly underestimated the maximum that could be attained.

It is well to recall these successes, as it is all too easy to focus only on the problems that remain. But a few statistics tell the story. First, even the moderately successful developing countries have attained more rapid rates of growth of per capita incomes than did the most rapidly growing countries in the 19th century! It is estimated that, for the nineteenth century as a whole, the average rate of growth of per capita output of the now-industrialized countries was about I per cent annually, with the most rapidly growing group of countries achieving about one and a half per cent per annum. Compare that with an average for ALL developing countries, of 3.0 per cent over the two decades from 1965 to 1985. Not only is the rate faster than anticipated, but it exceeded the rate of growth of per capita income of the industrialized countries, estimated to be 2.4 per cent per annum over the same period. While the difference is not great, there is some "relative" closing of the gap, and moreover, the learning process that we shall examine has been one that has led to accelerating growth rates in many countries and has simultaneously permitted those countries heavily committed to development to grow much more rapidly than the industrial countries. For example, Korea's growth of per capita income in a single decade surpassed that of England for the entire nineteenth century.

I shall point to other successes as I proceed, because the successes have been both cause and result of lessons learned about development. What I propose to do, therefore, is to take a brief tour of the problem-solving that development economists and policy makers have done since the 1950s. Some problem-solving has been the result of the efforts of researchers to provide solutions for pressing problems; some has come about as analysts have been able to contrast he results of alternative policies followed in different countries; and some has come about as spectacular successes have been carefully studied.

1. The Problem as Perceived in the 1950s

Although a few countries' governments had undertaken conscious efforts to achieve more rapid rates of growth of real incomes prior to the second world war, there was little articulated theory of under-development, or of how development might proceed, prior to 1945. To be sure, the Soviet Union had apparently achieved a great deal, and many students of development focussed on the Soviet experience in an effort to find policy prescriptions that would enable governments to accelerate economic growth in their countries.

But, while the Soviet experience contributed to, and perhaps reinforced, perceptions that guided thinking, it was not central to them. The dominant perception, reinforced by casual empiricism, available data, and to a lesser degree the Keynesian emphasis on investment and the resulting Harrod-Domar growth model, was that low income per person (which of course was by definition equal to low output per person) was the result of very low levels of capital input per person.

The recognition that an absence of complementary capital resources for workers would imply low productivity followed from common sense: it stood to reason that farmers with all types of farm machinery and equipment, with irrigated land and access to excellent and cheap means of transport to market, would be far more productive than their counterparts in developing countries who had at best ox-drawn wooden ploughs. Likewise, if one saw a then-modern European or American factory and contrasted it with the equipment available to cottage industries, there could be no question but that the absence of machinery and equipment with which to increase workers' productivity contributed enormously to the differentials in output per person.

Moreover, there was a straightforward, common-sense, explanation as to why capital stock per man was low: it was low because poor people could not afford to save very high fractions of their incomes because they were poor. As a result, the savings rate for a country with low per capita income would be low and hence, without additional resources from the rest of the world, the investment rate would be low. Statistics, of course, validated this set of observations: it will be recalled that there were many developing countries in the early 1950s where the estimated savings rate was between 5 and 10 per cent of GNP. Then and now, it is evident that one cannot hope for sustained and rapid growth without a rate of capital formation significantly higher than that.

To say that focus was on capital formation as the central problem of economic development does not deny that policy makers recognized other needs: any perusal of early development plans will reveal that there were targets for increasing education, health provision, and a variety of other factors integrally linked to development. But, to a significant degree, emphasis was unicausal: most observers regarded the problem of increasing the savings rate and otherwise raising resources

for more investment to be central, and to a large degree seem to have assumed that if capital formation were only accelerated, all other factors conducive to development would be forthcoming.

Before discussing the problem-solving behavior that addressed the "low-savings, low-capital-formation problem", it will be useful to mention for later use several of the corrollaries that appeared to follow from the focus on resource (meaning physical capital) accumulation focus of the 1950s. Three perceptions, related to but not necessarily associated with the capital-scarcity explanation of underdevelopment, were in fact associated with it. There was, first, the distrust of the international market, and an unwillingness to rely on it as an engine of growth. Second, there was a deeply-felt distrust of market mechanisms. Third, there was a strong belief that development consisted of shifting a country from agricultural activities to urban industrial activities.

Distrust of the international market rested on several pillars. First, there was the obvious historical legacy of colonialism and a belief that the colonial powers had used their position to extract resources from the colonies via the colonies' exports of raw materials. Second, there was the fact that most developing countries were exporters almost exclusively of primary commodities, and a belief that world markets for these commodities would grow at best slowly. Finally, there was a strong conviction that development would imply industrialization, and given the perceived weaknesses of domestic manufacturing activities contrasted with those of the developed countries, it was difficult to believe that industries could grow in developing countries that would be able to compete with those in the developed countries.

Distrust of the market mechanism also had several bases. There was the intellectual climate of the time, with the legacy of the Great Depression and the Keynesian prescriptions for government intervention at the macro level. Although the Keynesian analysis really applied to macroeconomic analysis in a comparatively short time period, it was natural enough to transfer the diagnosis of market-failure from the macro to the microeconomic setting. Then, too, the very fact that the newly-independent developing countries were so poor seemed to offer evidence that markets had indeed failed in developing countries. Furthermore, the Soviet experience seemed to indicate that

the one apparent case of successful development in the twentieth century had taken place in the context of a rejection of market mechanisms.

Belief in development through industrialization followed naturally from the perception that developing countries had been specializing in primary products, and from the belief that the significant difference between developed and developing countries was that the former had much larger proportions of their economic activity in manufacturing and related activities than did the latter.

From all of these perceptions, there emerged a view of the government as an active economic agent, and not simply as a catalyst or facilitator of the development process. Taking these insights together, the natural policy prescription for development in almost all developing countries was that government should take a lead role.

This lead role was to entail several things: (1) governments would set forth development plans, in which they laid forth the blueprint of the economy for the ensuing period of time, usually five years; (2) they would focus on raising the savings rate through the government itself, usually by raising taxes: (3) simultaneously, government would undertake a great deal of investment, including not only infrastructure in power, transport, communications, education, and public health—the traditional domain of governments in the industrialized countries—but also in public sector enterprises which would develop capacity for large-scale industrial activities, marketing of agricultural commodities, exporting and importing, and a variety of other tasks.

This description, while overly simplified for expository reasons, nonetheless fairly well depicts the philosophy underlying approaches to development in most developing countries. The perception of the problem-led therefore to problem-solving activities: efforts to "mobilize resources" were central. They included raising taxes (and improving collection capabilities), strengthening savings institutions, and obtaining foreign resources through foreign aid. And, as any study of development over the past four decades will show, those efforts were successful beyond almost all expectations. It was almost unthinkable in the 1950s that poor countries would be able to achieve savings rates of 15 or 16 per cent, much less over 20. Yet, by the 1970s, that was the record. Raising resources was perceived as the chief problem and problem-solving people

successfully reduced its magnitude. Who in 1950 could have thought that China could achieve a savings rate of 28 per cent by 1980, or that Korea could raise her savings rate from 3 per cent to 26 per cent? Developing countries as a group raised their savings rates to an average of 21.3 per cent in the 1960s and 25.8 per cent in the 1970s.

Investment rose even more sharply, however, as people in developing countries also focussed on the need for additional resources. Thus, the industrial countries that wanted to support development efforts thought in terms of a "transfer of resources", by which was meant that foreign aid could supplement domestic savings and permit higher rates of investment. Foreign aid did that, and did it successfully. In the 1950s and 1960s, when savings rates were still in the 10-15 per cent range, foreign aid that permitted current account deficits of 2-4 per cent of GNP raised the feasible rate of investment by 20-40 per cent—a very major contribution at the early stages of development. Official development assistance from individual countries and from the multilateral agencies provided a significant and important boost to resource availability at a time when the availability of investible resources probably WAS the binding constraint on the rate at which development could proceed.

2. Lessons of the 1950s and 1960s Perceptions

While there was success with regard to raising the savings and investment rates in many developing countries, other problems emerged which increasingly captured attention. These changes, like those that have followed later, have not been of a sort to constitute radical rejections of earlier perceptions. Rather they have been modifications, and additions, to our understanding of development. As such, perceptions of the process of development have become increasingly complex at each phase of the learning process.

The two problems which in the 1960s captured attention and led to successful efforts at resolution—at least at a conceptual level—were the bottlenecks created by shortages of resources other than physical capital and the imbalances that were generated by failures of agriculture to grow at satisfactory rates. These were not entirely unrelated, but nonetheless can be regarded as separate for present purposes.

Turning first to resource bottlenecks, it quickly became evident in many countries and many situations that the availabilities of resources

other than physical capital were important constraints to development. Perhaps the most noteworthy conceptual breakthrough was to enlarge the notion of capital to encompass both physical and human capital: investments in improving the quality of labor through education, on-the-job training, nutrition, health care, and even migration, began to be seen as of equal importance to investments in physical capital. While development economists and others had earlier recognized that there were particular specialities and occupations that were in very short supply in developing countries, they had not regarded the allocation of investible resources between physical and human capital as being of central concern. Experience in the 1950s convinced most observers that excessive investments in physical capital and neglect of human capital would significantly lower the rate of return on physical capital as engineering projects would yield low returns due to inability to inadequate skills for planning and maintaining them. Likewise, heavy focus on education might lead to the emergence of a trained labor force with few employment opportunities.

In addition to the enlargement of the capital concept to include human as well as physical, other resource constraints were noted: in some instances, institutions such as development banks were devised in an effort to correct these perceived difficulties; in others, such as "technology", the problem was labelled without any clear outlines of a proposed attack on it. Finally, and important for later parts of the story, in many developing countries it came to be perceived that "shortage of foreign exchange" was the limiting factor to development efforts. In many countries, "balance of payments" crises or inabilities to finance imports of certain goods led to the abandonment or suspension of half-finished investment projects, the postponement or cancellation of other development projects, and the operation of existing facilities at significantly less than full capacity in part because of an inability of managers to obtain needed inputs of raw materials, intermediate goods, and spare parts. While the amelioration of this problem was not widespread until the 1970s, foreign exchange came to be regarded as a separate factor of production in the late 1950s and early 1960s, and as such reinforced the tendency to regard development as a process requiring resource accumulation of many factors of production, rather than a single factor. This was the first significant break with the unicausal simplicity of the 1950s vision of the process.

The second lesson was equally to increase the complexity of the vision of development. In country after country, focus on industrialization led to a situation in which agricultural output grew relatively slowly. As this happened, export earnings from traditional commodities failed to grow very much, if at all, and simultaneously food supplies for the rapidly-expanding urban areas also grew more slowly than was consistent with stable food prices. In this circumstance, rising food prices put downward pressure on real wages. When this was offset by increases in nominal wages, the result was a sharp increase in costs of industrial production and downward pressure on profits. The resulting price cost pressures (or the social difficulties resulting from declining real wages) and the failure of export earnings to grow led to severe economic difficulties and usually a cutback in the rate at which industrial production could be expected to grow.

Analysis of the problems led to several interrelated discoveries which significantly increased understanding of the development process. First and foremost, it came to be recognized that a significant part of the failure of agriculture to grow was the result of the lack of appropriate incentives for production. Agricultural producers were, it came to be recognized, responsive to the incentives with which they were conforn-ted. When the real rewards for agricultural production fell (as they did when the relative prices of industrial goods rose, and when agricultural commodities' prices were determined principally through exchange rate policy and agricultural marketing boards which perceived their role to be one of tax collection for the government) the response as a shift to production of commodities whose relative prices had increased and then a failure to invest in yield improving activities or to harvest crops where labor costs exceeded the price of the output. Further, many migrated to the cities in the hope of obtaining more remunerative employment: and it had to be recognized that the outflow of resources from agriculture was detrimental and that the labor which had out-migrated had in reality had a very positive marginal product. Secondly, as the extent of the constraint imposed by agriculture came to be recognized, problem-solving efforts were increasingly directed to finding means of raising agricultural productivity. In addition to increasing incentives, this included the development of the high-yielding seed varieties: the Green Revolution was the result.

Even here, however, the lesson was complex: in order to find the right new seed, it was necessary to develop research and extension capabilities adapted to local conditions: one could not simply "take" the seed developed for, e.g. Mexican wheat and sow it in Turkey; it had to be adapted to local conditions, including the application of appropriate water, pesticides, insecticides, and fertilizers. In a nutshell, investment WAS important, but it was important as one part of a complex process which involved increasing resources for research, development, extension, irrigation, delivery of inputs at the right time and in the right proportions, as well as provision of adequate incentives to induce cultivators to produce the basic feedgrains and export crops.

The successes of the Green Revolution are too well known to require extensive comment here. With regard to incentives, suffice it to say that any remaining doubters have surely been convinced by the spectacular increases in agricultural output achieved by the Chinese since 1978. While there are still countries in which the lessons of the Green Revolution have not entirely been learned, and while there are many puzzles as to why agricultural growth may not be more rapid, it nonetheless remains the case that a lagging agricultural growth rate can no longer be regarded as a bottleneck to growth in most countries, the way it was in the late 1950s and early 1960s.

The great successes of the 1960s, then, were the achievement of rising savings rates (a trend that had started in the 1950s), the increased appreciation of the importance of agriculture in the development process, and greater attention to the importance of education and other productivity-increasing investments in labor.

As these problems diminished in importance, others emerged to the forefront. Chief among these were difficulties with the foreign trade regime, and the consequent "foreign exchange shortages", already alluded to. During the decade of the 1960s, however, some developing countries began to depart from the exchange-control, import-substitution model of development that had been standard in the 1950s. As they did so, they encountered phenomenal success and achieved growth rates that had earlier been regarded as infeasible. That experience then led to the chief lesson that was learned in the 1970s, however, and that is the decade to which I turn.

3. Perceptions and Problems of the 1970s

Already in the 1960s, the experiences of different developing countries had begun to diverge. Some had grown reasonably rapidly, and others had grown very slowly. Some met with severe "foreign exchange shortages", while others were highly successful in achieving "outer-oriented growth". These differences were accentuated after 1973: all oil-importing developing countries were confronted with severe incipient balance of payments difficulties after the oil price increases, but the outer-oriented countries recovered from the oil shock more rapidly than others. Even more surprising, oil-importing developing countries as a group experienced growth of gross domestic product at a more rapid rate than the oil-exporting developing countries. To add to the surprise, many countries which had successfully increased their savings and investment rates during the 1960s and early 1970s grew no more rapidly than they had a decade and a half earlier, while some of the outer-oriented countries actually accelerated their economic growth rate after the oil shock.

Putting these pieces of the puzzle and other evidence together, it became apparent that there had been two crucial mistakes in the assumptions underlying the import-substitution strategy: (1) the extent to which even traditional exports would be discouraged through both the exchange rate and the protection accorded to import-competing industries had been greatly underestimated; and (2) it had been assumed that new industries could develop only with protection and that an open trade regime would imply a failure of industry to grow rapidly.

Those developing countries that had relied principally upon import-substitution had experienced unsatisfactory rates of growth of export earnings and had simultaneously had more rapid rates of growth of demand for imports and import-competing goods than had been anticipated. The failure of exports to grow was later demonstrated to be a consequence of three facts: (1), the very high levels of protection accorded to import-substituting activities had resulted in very strong resource pulls into those activities at the expense of the production of exportables; (2) that same protection had further raised the prices of domestically produced goods that were inputs into exportable activities, thereby further disadvantaging the price-cost calculus for exporters; and (3) the maintenance of unrealistic exchange rates, which was possible

only because of the degree of restrictiveness of the import regime had led to reduction in the real return to exportable producers at the same time as protection had increased the rate for import-competing activities.

The second mistake—associating an outer-oriented trade regime with a continued comparative advantage only in traditional, primary-product activities—was certainly understandable. But the experience of the outer-oriented developing countries quickly demonstrated the potential for new lines of labor—intensive exportable activities to emerge. Not only did the East Asian exporters shift from 80-90 per cent exports of primary commodities to 80-90 per cent manufactures, but there were new lines of industry developing as they did so. The infant industry argument was not proved wrong: it simply proved that "healthy" infants grow up (quickly) to be exporters and do so best in an environment that provides a competitive discipline!

But deeper and closer inspection of the diverging experiences of developing countries revealed that the difference in trade strategy affected more than simply the industry composition of domestic output. It revealed a number of serious problems with import substitution that went far beyond "foreign exchange bottlenecks": (1) in part because of the small size of most domestic markets, import substitution industries were typically far too small to be economic in their size of production runs; (2) for the same reason, countries were caught in a dilemma of permitting one or a few firms to have a significant degree of monopoly power and permitting more firms with even higher costs due to small size; (3) as import substitution progressed, the remaining activities in which it could take place were more capital—intensive and higher cost so that there was a built-in tendency for the incremental capital-output ratio to rise over time more rapidly than it would under an outer-oriented trade strategy; (4) monopoly, or quasi-monopoly, power for domestic producers often led to sheltered domestic markets in which incentives for finding means of increasing productivity and for improving quality control were few with a consequent tendency for high costs and low quality; (5) the administrative apparatus necessary for management of an import-substitution regime became increasingly complex and burdensome as the industrial structure of the country grew more complex, to a point where no one could fully understand it; and (6) this had consequences both for the integrity of the regimes and for the political processes of the countries involved.

By contrast outer-oriented strategies penalized high-cost firms heavily, while simultaneously permitting and encouraging much greater expansion of low-cost and efficient producers than could take place in a closed domestic market. Countries could take advantage of their abundant supply of unskilled labor to compete effectively with developed countries in a variety of labor-intensive industrial activities—something unimaginable in early theorizing about development. Thus, some of the successful countries experienced very rapid rates of growth of industrial employment and real wages, so much so that they began, by the late 1970s, losing comparative advantage in some labor-intensive products and found themselves moving "upscale" in competing with developed countries in some more capital-intensive industries such as steel, chemicals, shipbuilding, and so on.

The greater success of the outer-oriented countries was demonstrated in a number of ways: their much more rapid growth rates (which exceeded the highest rates regarded as feasible only a decade before); their rapid growth of real wages and per capita incomes; the relaxation of any foreign exchange bottleneck and their emergence as creditworthy borrowers on private capital markets; and last, but not the least, their greater ability to adjust rapidly to the oil price increase and changed conditions in the international economy in the late 1970s.

However, even among countries that were not outer-oriented, there were significant differences associated with the degrees of restrictiveness of regimes: those more heavily oriented toward import substitution fared worse than those less heavily so. In light of the evidence, almost all observers were convinced, at least by the late 1970s, that there was no doubt that those countries which had adopted outer-oriented trade strategies had chosen successfully. If there were questions, they pertained to two issues: the appropriate timing and degree of trade regime reforms; and the repeatability of the choice in the 1980s and 1990s—a subject to which I shall return in my concluding remarks.

4. Lessons of the 1980s

The early 1980s were a disastrous time for the international economy, and especially for many developing countries. The oil price increase of 1979 was as much of a shock as the 1973 increase, in part because the share of oil in imports had risen and in part because many developing countries had not fully succeeded in adapting their economies to the

first price increase. When the worldwide recession which ensued was prolonged, resulting in the first drop in the volume of world trade in the post World War II period while simultaneously witnessing the lowest primary commodity prices since the Great Depression, the strains were enormous.

Even as developing countries were attempting to shift their trade and payments regimes to less restrictive and more outer-oriented bases, the declines in export earnings attendant upon low commodity prices, combined with rising nominal and real interest rates, led to severe balance of payments difficulties, and forced debt-rescheduling and emergency adjustment programs in a large number of countries.

It is not my purpose here to dwell on the debt difficulties of the highly-indebted countries, in part because Pakistan has not been faced with a debt problem of the same severity as many developing countries, and in part because it is the lessons and problems that have emerged from the debt crisis that are important for future development prospects.

There have been two lessons (1) macroeconomic imbalances are much more costly and harmful to development prospects than had earlier been thought; and (2) it is not only the trade regime, but also other aspects of microeconomic incentives which are important for rapid and successful economic development. To anticipate my concluding remarks, there are also new problems emerging to the fore, which will probably constitute the agenda of the 1990s. One has to do with the role of government in development, and the other concerns with the new and harsher realities of the international economy.

Turning to macroeconomic imbalances, little attention had earlier been paid in many parts of the world to price stability. Indeed, in the 1960s it was not obvious that countries with higher inflation rates (which were usually less than 20 per cent in any event) fared more poorly than countries with lower inflation rates. Many developing countries, confronted with the desire to increases public investment expenditures in excess of their ability to finance them, resorted to deficit financing. At first there was little visible cost. Some of the most rapidly developing countries, such as Korea and in the late 1960s Brazil, had rates of inflation higher than some of the more slowly growing ones. Over time,

however, countries with strong inflationary pressures have either taken steps to reduce them or they have been confronted with the urgent necessity to do so in crisis situations. In the latter case, the cost to growth has been very high, while even in the former, there have typically been several years of very slow growth as pressures of excess demand were brought under control. The lesson learned has brought a new concept to the vocabulary of economists: the notion of "sustainability". When high growth rates are based upon excess demand financed either by inflation or excessive foreign borrowing, that growth is unsustainable. When the country by choice or necessity finally comes to grips with the necessity of reducing inflationary pressures, the costs in terms of lower growth will outweight the benefits, if any, of the short-term higher growth rate.

Many developing countries, especially in Latin America, the Middle East, and Sub-Saharan Africa, are struggling today with the problems associated with severely curtailed public investment programs and maintenance expenditures as they attempt to restore fiscal balance. The lesson is rapidly being learned that large fiscal imbalances over the longer run are highly detrimental to growth. When added to earlier lessons concerning the trade and payments regime and appreciation of the role of agriculture as well as industry, our understanding of development has become still more complex as the role of macroeconomic management improves.

The second lesson of the early 1980s is the importance of all incentives facing decision-makers in the economy. While earlier attention had focussed on the trade and payments regime (which probably was the central problem at the time), the experience of the 1980s and especially the lessons emerging from the debt crisis demonstrate that almost all failures to reflect trade-offs to private decision makers can be costly, especially when there is a private international capital market in which local entrepreneurs can borrow. When firms have access to cheap credit, for example, the incentive is strong to invest in capital-intensive industries and techniques of production. The investment may prove profitable privately, but costly socially as societies fail to provide employment opportunities for their labor force and realize low social rates of return on some investments. Worse yet, when some firms have access to cheap credit while other smaller producers must depend

on their own resources (or pay much more dearly for it), the resulting resource misallocation can become severe. Interventions in the labor market—making the hiring of labor costly because of rules preventing dismissal, heavy social insurance payments, or unrealistic minimum wages—can likewise result in low real rates of return on new investments.

In the days of worldwide inflation, the inefficiencies associated with these investments were often partially obscured, as the availability of cheap credit from abroad and rapidly rising export prices permitted continued borrowing without commensurate growth in debt-servicing obligations. In the world of the 1980s, realities are harsher, and many of the countries experiencing the most severe debt-servicing difficulties are those which had policies in place which led to low rate-of-return investments.

5. Problems for the 1990s

As countries grapple with the lessons of the 1980s, a number of problems are coming to the fore, and will surely occupy our attention over the years to come. They follow logically from the experience, successes, and failures of the past several decades.

One such problem, already capturing attention, concerns the appropriate role of government and the private sector in economic development. A second, closely related to the first, focuses on the desirability and difficulty of undertaking reforms to put into practice the lessons of the 1980s. A third centers on the changing role of the developing countries in the international economy. The fourth issue is the very great difficulties of Sub-Saharan Africa.

Turning first to the role of government, in the 1950s and 1960s conventional economic wisdom taught that there was a set of ideal conditions under which markets would function perfectly, but that, in the absence of those conditions, there would be "market failure". When market failure occurred, the argument went, there was an appropriate role for governments to intervene to correct the failure. This might be done in a variety of ways, including taxes and subsidies to correct for externalities, direct government ownership of industrial activities (when, for example, monopoly was a problem or when the size of the enterprise was regarded as too large to be privately financed), government regulation of markets (if there were monopolistic hiring of labor, for example

or when marketing channels did not function smoothly in private hands).

There has been no change in the conventional wisdom concerning market failure but there has been added to it a set of concerns about "government failure". The implicit assumption underlying the "market failure: therefore let government do it" prescription was that governments had full information and could costlessly and unerringly devise appropriate interventions to correct all market imperfections.

Experience has demonstrated that government interventions are not always perfect, and that there are occasions, at least, when it is even more difficult to attain desired ends in the government sector than it is in the private. The necessity for reducing fiscal deficits has focussed attention on the efficiency and effectiveness of government expenditures in a number of countries. Government policies often require the development of administrative capabilities and procedures which themselves can be cumbersome. In many instances, public sector enterprises with an excessive number of employees, high costs, and visible inefficiencies are a major source of difficulty. In other instances, some components of public sector investment programs have been of questionable economic value.

Finding ways of making governments more efficient will surely be a challenge over the years to come. Related to solving that problem, however, is the more general question of the comparative advantage of governments and markets. Early development thinking neglected this issue, for reasons I indicated at the outset of this lecture. But while governments have under-taken a large number of economic activities, they have often neglected some of the tasks that are clearly essential for development: the more traditional infrastructure investments. As it is increasingly recognized that an outer-oriented trade strategy is likely to yield more satisfactory economic development than import-substitution, it must also be recognized that such a strategy calls for effective and low-cast delivery by governments of essential infrastructural services: without prompt and dependable communications, transport, and power, no set of incentives will induce really satisfactory export performance over the longer run.

Related to the issue of the appropriate role of government is the question of how to achieve reforms in instances when it is evident that

previous policies have been detrimental to development. One of the lessons of experience is that policies, once put into place, generate large constituencies supporting them, and it is politically difficult to alter them even if there is a consensus that the long-term benefits of so doing will be large. Once there is protection of import-substitution industries, for example, producers will oppose any attempt to move toward more uniform incentives for exportable and import-competing production. While experience in countries where reform has been undertaken strongly suggests that the damage to those producers will be far less than they fear, the natural uncertainty engendered by policy reform insures that all those hired by public enterprises, or all those protected by the prevailing import regime, will resist change. As such, appropriate management of reforms is of utmost importance for enhancement of development prospects.

A number of successful reform efforts have been undertaken in the 1980s, and in earlier years. Other reform efforts have been less successful or outright failures. One task of the coming years will be to distill the lessons that arise from those efforts in order better to understand how past mistakes can be rectified in a least-cost manner. Even with such an increased understanding, of course, it will still require political courage to undertake the appropriate reform measures but the required fortitude will be reduced as better knowledge decreases the risks and accelerates the benefits emanating from them.

The third issue which is likely to be reassessed in the coming years is the role of the developing countries in the international economy. Here, several things have changed since the 1940s and 1950s, but perceptions have not yet caught up with reality. First, developing countries are far more important to the international economy than they were in the early years. Their success with growth has made them more important as trading partners, and as actors on the international economic scene, than is currently recognized. There is still a tendency, especially on the part of policy makers in developing countries, to regard their economies as weak and helpless, and to view events in the international economy as largely outside their control. Second, the varying degree of success of different developing countries has reduced their homogeneity. If one takes simply the obvious categorizations, one could divide developing countries into low-income and middle-income; into primary commodity and manufactures exporters; into heavily-indebted and credit-

worthy; and into land-abundant and land-scarce. Even these simple criteria lead to sixteen different categories! If in addition one considers oil-exporters as separate from other primary-commodity producers, and adds even one or two more considerations, it quickly becomes evident that most simple generalizations now fail.

The end result of these two changes is that developing countries no longer have the extent of common interest that they earlier thought they did with regard to such issues as the Generalized System of Preferences (which provides relatively small benefits in any event), and in commodity price stabilization schemes (which have not been notoriously successful). Their commonality of interest has shifted far more to systemic issues in the international economy, and especially the openness of the international trading system. Because the success of an outer-oriented trade strategy is greater, especially for new entrants, in a rapidly expanding international market the stake of the developing countries in the Uruguay Round of Trade Negotiations is substantial. Yet, to date, despite some rhetoric, there has been little concerted attempt to find ways to use whatever influence developing countries may have to improve the likelihood of success of the Round in rolling back protection and assuring improved access to market. Indeed, some developing countries' spokesmen persist in believing that their interests still lie in special and differential treatment, even if that means degeneration of the system.

It seems to be a reasonable conjecture that, over the next decade or so, perceptions will catch up with reality, and the voice of the developing countries will more accurately reflect their common interests in international fora than seems currently to be the case.

The final problem concerns Sub-Saharan Africa. My theme today has been the successes of development, as problem—solving behavior has shifted attention with the better understanding and policies for addressing each, apparently paramount, obstacle in turn. The exception to that generalization so far has been Sub-Saharan Africa, where standards of living now are below their 1960 levels in most countries. It is to be hoped that, over the next decade, greater attention can be given to appropriate perception and resolution of the fundamental problems facing African development, so that those countries, too, can achieve the successes that have so far eluded them.

6. Conclusions

There is little doubt that understanding of the development process in 1987 greatly exceeds that of the 1950s. The successes have been greater than was earlier expected, and living standards have risen markedly in most parts of the world and astonishingly in some. Economic historians several centuries hence will undoubtedly mark the third quarter of the twentieth century as being a landmark in that it was by far the more rapid rate of economic growth for any comparable period in world history and in that those countries that had earlier been left out of the benefits of the industrial revolution finally were enabled to embark on more rapid economic growth.

The world of the 1980s and 1990s will not be as facilitative a one: the rapid growth of Europe and Japan in the quarter century after the war cannot be repeated; and the easy inflationary environment of the 1970s is unlikely to be replicated. Nonetheless, there is basis for optimism. Enough has been learned about development, and development policy, to make considerably more effective use of the available resources than was earlier possible. Indeed, to the extent that a harsher international economic environment is conducive to more effective use of available resources, it may not in the longer run be an entirely negative factor.

For developing countries, the problems now vary as the homogeneity of earlier years (which was in part more apparent than real in any event) has been replaced by diversity. The common interest now lies in a healthy, growing international economy that permits the developing countries to benefit from an outer-oriented trade regime. Those policies, for reasons I discussed, are most conducive to growth almost regardless of the international environment. However, to the extent that growth of the international economy is sluggish, or that the industrial countries become more protectionist, the attainable rates of growth for all developing countries will be lower.

For individual developing countries, key problems center around attaining an appropriate assignment of activities as between the private and public sector and finding ways to correct policies which earlier appeared appropriate but now seem high cost. If the past is any guide, progress will be made on these problems over the coming years, and it is interesting to speculate on the issues that will take center stage with their resolution.