International Development Policy: Two Recent Studies

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INTERNATIONAL DEVELOPMENT POLICY: TWO RECENT STUDIES *

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I

These two recent books deal with the economic relations between relatively rich and relatively poor countries, and with the flow of financial resources from the former to the latter.[1] Both cover the background and main policy proposals of the first United Nations Conference on Trade and Development; the conditions and prospects of the export markets of LDCs; and policies for increasing financial flows to them through commodity agreements, trade liberalization (by advanced countries), preferences for their manufactures, and expansion of foreign aid. Both authors also consider certain development factors and policies within the LDCs, Professor Johnson more so than Dr. Pincus; the former also reviews major proposals for international monetary reform. On the other hand, Pincus discusses the political climate and background of aid at greater length, and also reviews major development theories of the past and some more widely canvassed contemporary notions.

Thus the two books cover substantially similar ground and their authors share certain major approaches to policy. However, the similarity is superficial and deceptive.

II

Johnson's book is modest in size, wide in scope and impressive in quality. It covers a much wider range of issues than is suggested by the main headings. The usual injunction applies with special force that for adequate appraisal the book rather than the review should be read.

Johnson first reviews the background, proceedings and proposals of the 1964 UNCTAD, as well as certain major policy choices facing the United States following the conference.

* Following both authors I shall refer to the latter mostly as less developed countries (LDCs).

1. Harry G. Johnson, *Economic Policies Towards Less Developed Countries* (Washington, D.C.: Brookings Institution, 1967). John Pincus, *Trade, Aid and Development* (New York: McGraw Hill for the Council of Foreign Relations, 1967).

Some external and domestic determinants of economic development are next examined. While much of the discussion necessarily focuses on international aspects, the need for far-reaching cultural changes (interpreted here as social and political change) is recognized as a condition of material progress of poor countries. There is an illuminating discussion of the international diffusion of development, including the role of external contacts in domestic transformation. Some more narrowly economic effects (in the sense of those readily susceptible to formal analysis) of external assistance are also discussed. Johnson recognizes that external contacts will not transform society if the traditional social forces are strong. He also thinks that resistance to change was encouraged by the former colonial powers. This last suggestion needs qualification. It is one of the countless assertions canvassed by spokesmen of LDCs designed to blame external factors for the material backwardness of their countries. The colonial regimes have often promoted the most far-reaching transformations, as for instance in Gold Coast-Ghana, Southern Nigeria, Malaya, Hong Kong. However, these regimes have often hesitated to destroy by coercion certain traditional values, customs and social institutions. In India the British administrations were prepared to attack suttee, but not the sanctity of cattle; in West Africa cannibalism and slavery, but not polygamy. In any event, it is a matter for conjecture whether large-scale coercive attacks on traditional institutions, especially when emanating from abroad, would have promoted material progress. Moreover, in many newly independent LDCs, notably India, Burma, Ceylon and Indonesia, the governments have come to support many traditional attitudes most damaging to material advance.

Johnson then reviews policies of poor and rich countries which obstruct the development prospects of the former. The policies of LDCs and their implications examined include the operation of the planning mechanism and of the controls for its implementation; the unfavorable treatment of agriculture through the depression of farm prices and the raising of prices of farmers' purchases; the heavy subsidization of manufacturing, partly as an instrument of import substitution; the maintenance of overvalued exchange rates by means of exchange controls; and the restrictions on the inflow and deployment of foreign capital. The effects of the high rates of effective protection (that is protection or other subsidy as percentage of value added and not as percentage of the value of final output) are often compounded by the overvaluation of the currency and the escalation of protection (imposition of higher rates of duty on the final stage of manufacture). These policies result in wide discrepancies between private and social opportunity costs, the extent of which is at times ascertainable Johnson notes that there are many instances of activities in LDCs enjoying net subsidies of over 100 per cent of value added.[2]

Two topics discussed in this context are the inadequacy of the familiar distinction between the so-called foreign exchange gap and the savings gap (the failure to relate the saving-investment relationship implicit in the balance of payments to that of the other macroeconomic magnitudes); and the relationships between the degree of import restriction and the relative attractiveness of external aid compared with domestic savings as an instrument of development.[3]

The tying of aid, protectionism, and immigration restrictions are among the major policies of advanced countries which affect LDCs adversely. Tying of aid diverts part (often much) of these gifts to suppliers in donor countries; it diminishes the gift rather than obstructs development or inflicts a cost. Johnson's excellent discussion of the extent of the protection of processing industries is exceptional in analytical precision, in the supporting empirical evidence, and much more so in the combination of the two.

Johnson argues that a liberal international order, supplemented by foreign aid in cash grants (as distinct from soft loans or tied aid) would most effectively supply the external resources required for the advance of LDCs. His formulation deserves to be quoted at length because of its importance in the book, and as an example of his succinct and yet comprehensive exposition:

> Theoretically, the best solution to the problem of providing additional external resources for the acceleration of development would be free trade, plus the provision of aid on a scale determined either by the net resources required to support rates of growth in the less developed countries endorsed by the developed countries, or by the amounts of resources agreed on by the developed countries to be necessary to fulfil their commitments to the less developed countries. This would be the best solution for the developed countries because protectionism in all its manifold varieties wastes their resources and impedes their own growth. It would be the best solution for the less developed countries because all of the solutions proposed at UNCTAD are inefficient means of supplying one of two things: more net aid from the developed countries, or improved access to developed-country markets.[4]

Johnson suggests that the substantial and influential groups in developed countries which would lose through freer trade should be

2. *Op. cit.*, p. 73.
3. *Ibid.*, pp. 53, 57.
4. *Ibid.*, p. 114.

compensated. In the context of his discussion this is only a secondary point, but it raises an interesting general issue.

Most instances of government induced change are likely to damage some groups. Is it generally feasible, desirable or just to compensate those harmed; and if so, at whose expense, and how is the damage to be measured? Further, how should one treat those who benefit from government induced change, as for instance the reduction of taxation on their products? Potentially adverse effects of change are risks of economic activity; differences in the likelihood of their occurrence and in the extent of their adverse effects are presumably reflected in the rewards and returns. The case for the compensation of victims of changes of policy seems particularly doubtful in previously subsidized activities, since the possible withdrawal of assistance is a commercial risk. The most practicable, and perhaps least inequitable course (which is after all the best one can hope for) may be to leave the outcome to the combined pressures of the political process and the play of market forces. However, compensation may be advocated and paid on occasions as necessary for the acceptance of a specific measure, rather than as an instance of a general principle.

Johnson's arguments for substituting cash grants for soft loans and tied aid are convincing. This change would enhance the effectiveness of a given volume of aid, enable its exact amount to be calculated and reduce political friction. It would also simplify the assessment of the incidence of aid. Much of tied aid is a subsidy to exporters. This effect is enhanced when, as often happens, particularly with services, agricultural surpluses, and also with certain types of equipment, the least marketable and relatively uncompetitive supplies are prominent in the tied aid program. Some of the arguments on the internationalization of aid are also cogent. Johnson rightly argues that a collective agency of the recipients would have to face the inevitable and unenviable task of allocation. On the other hand, internationalization of aid would sever the link between the suppliers and the users, thereby removing what little interest the former have left in the deployment of the resources they supply, which is likely to diminish the effectiveness of aid.

Johnson recognizes both the contribution which private foreign investment can make to development of LDCs, especially to their modernization, and also the political and economic obstacles to its flow. He specifically notes the contribution of foreign firms in the service industries, whose operations he thinks arouse less opposition than do those in manufacturing and mining. This suggestion applies to Latin America, Europe and perhaps the Far East, but not to South East Asia and Africa where the belief that the service industries are unproductive, and more important, the political effectiveness of local traders, have brought about severe restrictions on the activities of expatriate firms in the service industries — transport and trade (both wholesale and retail).

International commodity agreements and arrangements, preferences for manufacturing exports and customs unions among LDCs are examined at some length. Notable features of the discussion of commodity agreements include disentanglement of frequently confused objectives, and recognition of the limitations or outright disadvantages of superficially attractive arrangements.[5]

Johnson explicitly and rightly distinguishes between increases in real income and in foreign exchange earnings as objectives of policy. The significance of this distinction transcends both commodity policy and the position of LDCs. Chiefly as a result of currency overvaluation and of exchange controls, the idea has become widespread that foreign exchange expenditure alone represents scarce resources, and domestic money is unsubstantial — somewhat akin to a stage army.[6] This approach results in extremely wasteful policies. I hope that Johnson will come to write more on this important point.

Johnson's discussion of the UNCTAD proposals for trade preferences for manufactured exports of LDCs is thorough, comprehensive, and authoritative. He shows that even within comparative statics it is difficult conclusively to assess the effects of changes in tariffs and preferences when the complexities of customs union theory, the theory of the second best and of effective protection are recognized; and these defects are cumulated by the presence of imperfect competition and of differentiated products. He finds no evidence for the much canvassed infant industry and scale effect arguments in favor of subsidized manufacturing. On scale effects one could perhaps go further. This effect is unlikely to be significant for most types of viable manufacturing in LDCs whose comparative advantage is in labor-intensive activities using relatively simple techniques. This presumption is supported by the success of Hong Kong

5. Johnson's concern is with the international aspects of commodity arrangements. The domestic aspects of their operations are also often significant in LDCs where their enforcement inflates costs, often inflicts considerable hardship, and may also create major political and administrative problems.

6. An inappropriate application of Keynesian ideas (themselves rather oversimplified) of costlessness of resources in conditions of general unemployment may also have played a part in promoting these ideas. More recently the belief in the alleged costlessness of expenditure in domestic currency has been reinforced by the suggestion of the advocates of foreign aid that when the recipients spend aid in the donor countries the latter incur no costs.

as producer and exporter of manufactures, a country with a very restricted domestic market (minute when it first successfully entered the world market), and by the multiplicity of enterprises in the principal export industries not only of Hong Kong, but also of India, Pakistan and even Japan (especially in the earlier days of Japanese industrialization).

Although the arguments for general preferential treatment for manufactures of LDCs are defective, there is no doubt about the high barriers to the entry of products into developed countries especially through import quotas and high effective protection. Johnson shows clearly the scope for the enlargement of export markets for manufactures from LDCs through the reduction of these barriers and the selective granting of preferences. He also notes that the ability of different LDCs to benefit from additional opportunities would depend on the level of costs and the elasticity of supply of their manufactures, factors at present adversely affected by currency overvaluation and costly policies of import substitution.

Moreover, the domestic repercussions of an increase in exports are also uncertain. More liberal trade policies of the advanced countries may help appreciably the development of a few LDC's but probably not that of the majority. This tentative conclusion is suggested by the very different recent export and development experiences of Japan, Hong Kong and Israel on one hand, and of India, Burma, and Indonesia on the other hand.

Johnson observes that some popular objections to preferential arrangements among LDCs are unsubstantial, but he also notes that such arrangements are often, indeed usually, designed to promote manufacturing as such rather than to promote the most effective deployment of resources. Thus, even if desired by the government, they do not necessarily accord with the interests of the population at large: one of many examples where the government is best seen as a sectional interest. Preferential arrangements among LDCs also reduce their economic contacts with advanced countries which are potent instruments of material progress.

A smoothly functioning international monetary system eases the international spread of material progress; and payments problems affect the readiness of countries to liberalize their commercial policies and to supply aid. Johnson, therefore, examines the major differences between the principal current proposals for monetary reform. He does not take sides except for pointing out the inappropriateness of attempts to link the provision of additional international liquidity with a surreptitious provision of aid.

In conclusion, Johnson summarizes his own proposals. He urges the United States to reduce its own barriers against exports from LDCs, or at least to pledge itself not to increase these further. He also suggests the appointment of an expert review panel for the examination of the effects of U.S. import restrictions on LDCs. If trade liberalization is not practicable, Johnson would accept as poor second bests international commodity agreements and preferences to manufactures from LDCs. He also envisages increased foreign aid, especially in the short run, though he recognizes that its effectiveness depends on its use.

Johnson's substantial entry into development economics is most welcome. Development economics, which presents issues of much intellectual and practical interest has found it difficult to establish reasonable standards. The problem of quality control of output in the social sciences is especially acute because the difficulties of conclusive and convincing reasoning in economics are compounded here: the complex, unresolved problems of methodology when the progress of whole societies is examined; the appropriate conditions and limitations of *ceteris paribus*; the assessment of the relative importance of different variables, and their interaction with the parameters; the unhistorical nature of much of contemporary economics (the limitations of which affect development economics especially); the intense preoccupation with practical and political issues, and the intrusion of political judgment into apparently neutral reasoning; and the rich rewards for politically acceptable work, regardless of quality. The difficulties of quality control are enhanced by the rapid expansion of output in response to a greatly expanded and insistent demand. It is not accidental that the allegations are frequent and strident in this literature that objective reasoning is impossible, that the distinction between positive and normative reasoning is fictitious, for such reasons as the overriding importance of political factors, or because of differences in levels and rates of development between rich and poor countries, or in values and mores between different societies. Such allegations, often a compound of intellectual sloth and political expediency, serve as spurious justification for the disregard of elementary standards of competence, clarity and rigor.

Johnson's magnificent command of analytical and applied microeconomics, macroeconomics and monetary economics is evident throughout, both in the sophisticated unraveling of complex issues, and in the treatment of comparatively straightforward matters. His treatment reflects that firm grip on fundamentals which is the hallmark of true expertise. There are certain peaks: the analysis of preferences; the treatment of the analytical and practical implications of the differences between nominal and effective rates of protection; and the examination of commodity agreements and of the main issues in monetary reform. But the peaks rise from a consistently high plateau.

In many ways this book is a major piece of slum clearance. Johnson shows that over a wide range of issues of trade between developed countries and LDCs, economics can clarify issues, phenomena, and implications of policy. He shows that discrepancies between real and money costs, the presence of scale effects, product differentiation and imperfect competition, can readily be incorporated into the analysis, and so can to some extent the operation and implications of political pressures. Our inability to know everything does not mean that we cannot say anything. And it does not justify the adoption of such anti-intellectual postures as a denial of the relevance of analytical reasoning and of empirical evidence, and the elevation of political effectiveness to the only meaningful criterion of the merits of a discussion.

The presentation is also of a high order. Concise treatment enables Johnson to cover a wide field without cutting corners or shirking difficulties. The discussion is also refreshingly free from pretense. Without oversimplification, Johnson tries consistently to make difficult things simple rather than simple things difficult.

The infelicitous use of industrialization to denote modernization is a minor blemish on the high level of presentation. Johnson writes that industrialization is necessary for economic development.[7] But he is explicit and indeed emphatic that by industrialization he does not mean "the establishment of 'industry' (the production of manufactured products) as distinct from and in replacement of 'agriculture' (the production of commodities from the soil)." He uses the term to mean modernization. But then why not use the latter term instead of one which usually describes different processes, phenomena, and policies? Industrialization does not readily convey changes in attitudes, values, outlook and institutions; it scarcely describes that modernization of the mind which is a condition of a modern economy. Moreover, industrialization in the sense of subsidized development of manufacturing often substantially impedes modernization (as is clear from Johnson's criticism of protectionism in LDCs), so that the two policies or phenomena denoted by the same term are often incompatible. Indeed, Johnson himself does not confine the

7. *Op. cit.*, p. 45.

term industrialization to modernization; at several places he applies it to the subsidized development of manufacturing even when he criticizes this policy. One is dismayed by the prospect of numerous graduate students claiming Johnson's high authority for the necessity of subsidized or sponsored industrialization.

If I now mention certain limitations (largely self-imposed) of this cornucopia my purpose is not to subscribe to the practice of many reviewers of criticizing a book for being on a subject of the author's rather than the reviewer's choice. Recognition of certain limitations of this rich treatment may serve to enhance its pedagogic and practical usefulness, and to encourage further development of some of its arguments.

Johnson nowhere compromises the integrity of his own arguments. But in discussing the arguments, claims and grievances voiced by governments, spokesmen and supporters of LDCs he confines himself to the more reputable, or at any rate the least disreputable, contentions. The most blatantly inadmissible arguments and statements in the publications he mentions are insufficiently exposed: the vicious circle of poverty; the alleged responsibility of rich countries for the material backwardness of LDCs; the allegedly inevitable payments difficulties; the crudest allegations of the ever deteriorating terms of trade; and so on. Even brief exposure of some of these argumentations by Johnson might have helped to remove them from the arena of discussion. As it is, the slum clearance is insufficiently ruthless; and the flavor of the typical discussions (including academic discussions) of these issues does not come through.

The other limitation is in the treatment of those major determinants of material progress which cannot be easily handled by economic analysis in which they are usually disregarded altogether or treated parametrically. Johnson knows their significance as is clear from his concise discussion [8] of social and political factors, and of the historical background of Western development. But he does not discuss as major influences people's faculties, attitudes, and objectives. And he does not emphasize the interaction between the variables comprehended in economic analysis (which the policies he examines are designed to influence) and political, social, cultural, institutional, and personal factors. The methods by which the conventional or familiar variables are changed often affect development more than the changes in the variables themselves. For instance, controls designed to increase the rate of saving, or to influence the pattern of investment, often affect external contacts, the supply of

8. *Op. cit.*, pp. 44–45.

incentive goods, the position, activities and prospects of particular ethnic groups, and occupational and geographical mobility within the economy. They also often increase the stakes in the struggle for political power, enhance political tension and divert attention and energy from economic to political activity.

The relevance to the outcome of the method by which a variable is changed is characteristic of historical processes, in contrast to most functional relationships treated in economic theory or amenable to scientific techniques; and this relevance is one of the several reasons for the limitations of economic theory in the analysis of economic development. Johnson's pioneer work on the economics of nationalism suggests that he is well qualified to examine this range of issues.

III

Dr. Pincus' book is a volume in the Atlantic Policy Study Series, which according to the Preface of the Director of the series, comprises major works designed primarily to promote policy.[9] Much the best parts of the book are those on the climate of aid, particularly on the mixed considerations and motives behind it: political and military strategy; guilt feeling for prosperity as such, or for genuine or alleged past wrongs; real or supposed economic benefits to the donor country or to influential pressure groups; ethical sentiments to reduce the international inequality of incomes. Although the discussion perhaps underrates the role of certain pressure groups such as export interests, national and international civil servants and consultants, and professional humanitarians, it conveys successfully the climate of aid and the play of political forces.

Certain other specific topics which are well discussed include a review of some of the classical and neoclassical theories of development, and of the use and limitations of programming techniques.

But the general level of the discussion is kept at a disappointingly low level presumably in order to make the book more accessible or acceptable to lay readers. Indeed the book would not deserve extended review in a serious journal were it not for its authorship by a staff member of RAND, and for the publicity secured both by the series and by this book, as reflected, for instance, in the invitation to review it together with Johnson's study. I shall draw attention to some major characteristic shortcomings in the treatment of the main topics.

9. *Op. cit.*, p. vii.

Pincus regards external market conditions, notably unfavorable present and prospective terms of trade, a major adverse factor in the foreign exchange availability and the development of LDCs. He emphasizes the adverse implications of low income and price elasticities of demand for exports of primary products.[1] No specific evidence is offered for the supposedly low values of these elasticities. At one point Pincus writes:

> As long as world demand for industrial imports is rising faster than world demand for primary imports, the terms of trade of primary exporters will tend to deteriorate, other things being equal.[2]

Prima facie this passage (on which much of the subsequent argument rests) means that the terms of trade of primary producers will deteriorate if the demand for manufactures increases faster than that for primary products. But this conclusion is invalid unless either the income elasticity of demand for primary product imports is not only *low* but *negative*, or if manufactures are produced under conditions of increasing real costs. Neither of these conditions applies. The latter is indeed inconsistent not only with standard economic analysis but with Pincus' own discussion of increasing returns. Pincus may possibly have something else in mind. He may perhaps have been thinking of conceivably short period disequilibria (which may be indicated by the use of the present participle "rising"). But such an argument would be irrelevant to the long term prospects of LDCs which are Pincus' concern.

Pincus lists[3] the major commodity exports of LDCs — petroleum, coffee, natural rubber, cocoa, tea, sugar, fats and oils, cotton, nonferrous metals. The income elasticity of demand for these products is unlikely to be low, let alone negative.

The suggestion of a low price elasticity is indeed contrary to Pincus' emphasis on the problems presented by the development of substitutes and the reduction of the raw material content of final output. The presence of substitutes produces a high price elasticity. A reduction in the share of raw materials in total cost will tend to increase the price elasticity of demand if the elasticity of substitution between raw materials and other productive resources exceeds the price elasticity of demand for the final product.

The numerous references to the terms of trade of LDCs are entirely to commodity terms; factoral terms of trade are not mentioned. Yet even an elementary discussion must recognize that it is

1. E.g., *op. cit.*, pp. 235, 247 and *passim.*
2. *Ibid.*, p. 130.
3. *Op. cit.*, p. 262.

these which are relevant to income, development and welfare. References to changes in export prices or terms of trade are meaningless without reference to costs.[4] Worthwhile discussion would need also to note changes in the quality of manufactures and in the volume of trade. The former is not mentioned at all, the latter only incidentally.[5] It is this level of discussion which enables Pincus to suggest that the debate on the persistent decline of the terms of trade of LDCs between Dr. Prebisch (or the Singer-Myrdal-Prebisch school) and their critics is unresolved.[6]

In fact even the commodity terms of trade of primary producers or of LDCs show no secular deterioration. In recent years they have been and still are more favorable than almost any time over the last century or so; the factoral terms are almost certainly much more favorable than the commodity terms.[7] The single factoral terms of trade is the most relevant concept in the context of the welfare implications of changes in the terms of trade. The single factoral terms of trade can improve (and over long periods usually do so improve) for most or all trading partners; the gains of some are not offset by the losses of others. In much the same way that economic activity is not a zero sum gain, the operation of the single factoral terms of trade does not produce a zero sum either. The single factoral terms of trade of all or most underdeveloped coun-

4. This consideration is not a refinement, but is obvious and fundamental, especially in the context of primary products. At the end of the nineteenth century rubber was collected at great expense from trees in the jungle, while within a few years it came to be produced at a fraction of this cost on estates and smallholdings. Petroleum, cocoa, sugar and vegetable oils are other exports whose costs and methods of production have changed vastly over the last few decades. These influences still operate strongly. For instance, the development of high yielding rubber planting material in the 1950's and its extensive adoption have greatly increased yields of both rubber estates and smallholdings.

5. Import prices are usually compiled by dividing total volume by the weight or numbers of the items imported, which either ignores changes in quality and in variety or allows for this factor only imperfectly. LDCs import many products which have only recently appeared in their import lists, notably technical goods, consumer durables and many chemicals and plastics. Moreover, the performance and quality of many manufactured imports have changed so greatly over the last half century or so that the products are the same in name only, though this is ignored in most foreign trade statistics: locomotives, motor cars, earth moving equipment, radios, are obvious examples. These influences are still at work.

Somewhat analogous welfare considerations apply when there are great changes in the volume of exports. In the early years of the century, a few thousand tons of plantation rubber were exported annually from Malaya and the Netherlands East Indies (the present Indonesia) at very high prices. By the 1920's, the price had fallen greatly, but annual exports were in hundreds of thousands of tons with far greater welfare and income generating significance.

6. *Op. cit.*, p. 132.

7. See for instance Sir Arthur Lewis, "A Review of Economic Development," *American Economic Review*, LV (May 1965), 8.

tries are almost certain to be more favorable than practically ever before.

Pincus notes[8] that any discussion of the terms of trade is fundamentally affected by the choice of the base year. This recognition lends interest to his choice of 1951 as a starting point and 1952 (the Korean boom years) as the base for the discussion of the terms of trade in his chapter on commodity trade and policy.

The defects of the discussion may be obscured to the lay reader by a mass of detailed and largely irrelevant statistics. For instance, the composition of the exports of the most insignificant of LDCs is shown in some detail[9] in the chapter on commodity trade and policy which does not mention factoral terms of trade. Irrelevant statistics and pointless statistical associations abound, as do ambiguities, ambivalences and inconsistences of terminology and argument.

The frequent often ambiguous references to shortages or scarcities of resources seem sometimes to denote primarily excess of demand at prescribed prices;[1] at other times a low level of resources compared with the position elsewhere;[2] at other times a limitation of resources compared with free goods;[3] and at yet other times an excess of aspirations over available supplies.[4]

Pincus recognizes[5] that the much publicized foreign exchange gap is simply a short-fall of resources for the attainment of a specified objective, in this case the securing of a rate of investment deemed necessary for a postulated rate of development. But he usually implies a fundamental difference between a foreign exchange gap and a resource gap, though this treatment conflicts with his own correct analysis in the passage just mentioned. He regards a chronic shortage of foreign exchange as inherent in attempts to reach a tolerable rate of development. Yet many LDCs have developed rapidly since the beginning of the century without foreign exchange difficulties. There is no special gap or constraint of foreign exchange in which there is not also a constraint of all other, domestic, resources including land and human resources. The gap is simply a corollary of attempts to use more resources than are available from current output, draft on reserves, and foreign loans. The emphasis on its special significance reflects in part overvalued exchange rates;

8. *Op. cit.*, p. 131.
9. *Ibid.*, Tables 24–28.
1. *Ibid.*, p. 181.
2. *Ibid.*, p. 131.
3. *Ibid.*, p. 303.
4. *Ibid.*, pp. 301, 352.
5. *Ibid.*, pp. 300–301.

in part insistence of external causes of material backwardness; and in part a superficially plausible argument for foreign aid.

Pincus frequently blames the advanced countries of the West (only of the West) for the poverty of LDCs. At times the blame refers to insufficient aid,[6] at other times to alleged extraction of wealth. He writes:

> Finally, Marxism may fail to construct a logically credible picture of how the trade-development relation works, but this does not mean that we can therefore dismiss it. There is some argument for many of the Marxist and neo-Marxist tenets of imperialism. Even if the net gains to the North from imperialist policies are relatively small, they loom large in the eyes of the poor countries. No one wants to be exploited.[7]

It is not stated here (or in other related passages [8]) why and how the advanced countries have exploited the LDCs.

Contacts with the West have opened new sources of supply and new markets for LDCs; they have acquainted their peoples with new crops, methods and wants; they have undermined the customs most adverse to material progress; and they have often first suggested the idea of material change and advance

Few readers can infer from Pincus' reference [9] to economic and political domination by the North (by which he means the West) that throughout the underdeveloped world the poorest and most backward regions are without contacts with the West, and conversely the most advanced and rapidly advancing are those with which the West has established contact; or that the LDCs were generally extremely poor, indeed materially primitive, when the West established contact with them, as is obvious of nineteenth century sub-Saharan Africa and most of South East Asia. Moreover, the concept of material progress is of Western origin. Materially at any rate the presence and activities of the rich countries have greatly benefited the LDCs.

Certain policies of the rich countries, notably their import restrictions, imply that economic contacts are less extensive and the benefits to LDCs less than they would be otherwise. The tying of aid means that the nominal value overstates the real value. Again, if the commodity or factoral terms of LDCs with rich countries were more favorable they would benefit from trade more than they do already. But none of this warrants the suggestion that the rich countries of the West have somehow impoverished the LDCs.

6. E.g., *ibid.*, p. 353.
7. *Ibid.*, p. 106.
8. E.g., *ibid.*, pp. 173, 350, 374.
9. *Ibid.*, p. 173.

Allegations of external responsibility for the backwardness of LDCs result in attitudes and policies adverse to development. They divert attention from the basic causes of material backwardness and thus from the possibilities of influencing them. They also serve as spurious justification for various policies obstructing development, notably restrictions of external contacts, and also activities of commercially successful ethnic minorities.

The relation between industrialization and economic development is a recurrent theme of the book. The treatment is confused, as is that of the related subject of import substitution. For instance Pincus uses the term industrialization interchangeably to cover both the development of manufacturing with the secular growth of the economy, and also government sponsored and subsidized manufacturing, a distinction of analytical and practical significance.

The discussion of government sponsored accelerated development of manufacturing is ambiguous throughout. At times Pincus suggests that it might reduce the measured national income but may still be desired by the nation (that is, by the government or other sectional interests) for reasons of prestige, so that the costs are offset by psychic income.[1] At other times he suggests that subsidized industrialization is likely to increase the national income by correcting discrepancies between money and real costs, or on infant industry arguments.[2] More generally, he argues that sponsored or subsidized industrialization is usually warranted because short period criteria of efficiency are poor guides to policy for long term development, especially since manufacturing is an efficient instrument of dynamic transformation. According to Pincus, the case is confirmed both by the practice of the developed countries which have invariably protected their nascent manufacturing industries from foreign competition; and also by the statistical association between economic development and manufacturing industry.

Pincus seems to imply that whatever the government does in this sphere is desirable either because it reflects the popular consensus, or because it corrects for a discrepancy between money and real costs, or because it promotes dynamism in the economy. Such an approach is unwarranted. Any particular pre-existing situation may well not be optimal according to certain criteria. But it does

1. E.g., *ibid.*, p. 170.

2. *Ibid.*, p. 134. In one instance Pincus writes (*op. cit.*, p. 123) that the infant industry argument and the argument based on divergences between money and real costs are in fact identical. This is certainly not correct as a general proposition: one argument is based on static economic analysis, the other on changes in comparative costs through time.

not follow that the subsidization of certain activities will result in improvement. An uneconomic deployment of available resources may possibly accelerate their long term growth. But the presumption is the other way because of the reduction in current national income. The burden of proof (which is usually undischarged) is on those who suggest the contrary. General references to infant industry arguments, or to divergences between real and money costs, or to dynamic considerations, are insufficient.

Discussion of the merits of accelerated industrialization is often confused both by focusing attention on particular activities or sectors and ignoring costs; and also by inappropriately attributing causal relationships to correlated variables.

The suggestion [3] that subsidized manufacturing industry by itself yields a psychic income strikes at the root of the use of the national income for measuring international inequality, and also as basis for sharing either the burden or the allocation of aid.[4]

The most interesting points of Pincus' discussion of government sponsored manufacturing relate to its alleged effectiveness as a propellant of dynamic social change. Pincus sees in the resistance to change of traditional agriculture a major argument for accelerated industrialization.[5]

Pincus' familiar formulation obscures the central fact that an economy consists of people. Once this fact is recognized, wide, interrelated issues of the purpose, likely results and costs, method and agency of change necessarily arise. These are not discussed by Pincus. For instance, what instruments and methods of change, especially coercion, are we prepared to advocate if people's economic faculties, attitudes, mores, and institutions are unfavorable to material advance? [6]

Resistance by the rural population to change usually reflects deeply embedded and long standing faculties, attitudes, and mores.

3. Explicit, *ibid.*, p. 170, and implicit, p. 204.

4. Interesting problems of the incidence of costs are raised when manufacturing is subsidized by governments which receive aid, the volume of which is in any way influenced by the level of the national income. If subsidization of manufacturing affects the national income adversely, part of the cost may fall on other sectors of the domestic economy, part of it on the aid donors, and part of it on other potential aid recipients. This conclusion is only one instance of the material interest of the last two categories in the policies of aid recipients.

5. Especially, *ibid.*, p. 158. The reference is clearly to small scale agriculture. If the term "traditional" is interpreted as resistant to change, the idea reduces to a meaningless tautology.

6. Throughout this article, references to qualities, capacities, or faculties are solely to those making for material success. Rich people are not necessarily more admirable or happier than their fellow men.

Subsidized, and usually costly, transfer of resources from agriculture and service industries to manufacturing industry is unlikely appreciably to affect the capacities, attitudes, and customs which most impede material progress. Urbanization might in some instances have the result often attributed to the growth of manufacturing, but this result is by no means certain and would depend on the conditions by which it is brought about. Moreover, urbanization is not the same as the growth of manufacturing.

Modernization of attitudes (in effect modernization of the mind) and of institutions is a condition both of economic development and of successful development of viable manufacturing. But accelerated industrialization does not in itself promote this modernization.

In the conditions of many, probably most, LDCs, particularly in South Asia and Africa, the development of cash crop production is likely to be more effective for the modernization of attitudes and institutions which promote a rise in living standards (as distinct from the growth of particular sectors and activities of the economy regardless of cost). This presumption derives from the need in these countries to promote attitudes and institutions appropriate to the exchange economy. The production of cash crops is more effective for this purpose because it does not require simultaneous acquisition of new techniques and of the attitudes and institutions appropriate to the exchange economy.

Pincus' frequent references to industrialization in nineteenth and twentieth century Europe and North America as an example for LDCs, ignore the fact that these areas were by then economically far more advanced than most of the LDCs at present; that they usually had centuries of development behind them; and had long been largely pervaded by the institutions and attitudes of the exchange economy.

Nor do small farmers always resist change. Pincus is unfamiliar with some of the countries he specifically mentions. He instances Ghana as a country where the traditional society was not altered profoundly by the cocoa industry.[7] But there have been most far-reaching changes in the conditions of life of the African population of Gold Coast-Ghana. There is an extensive literature on these far-reaching changes, and on the social and political problems set up by their impact.

Pincus contrasts the experience of Ghana with that of nineteenth century North America and the white British dominions (as well

7. *Op. cit.*, p. 125.

as Taiwan, Israel and French Algeria) without noting the difference in historical background, the qualities, attitudes, and institutions of the populations. As late as the 1880's, conditions on the Gold Coast were extremely primitive, indeed barbarous and savage. There were no schools or man-made communications, and there probably still was cannibalism. Pincus contrasts the export sector of the Gold Coast with that of nineteenth century North America and the British dominions to the detriment of cocoa as an agent for transformation, apparently because economic and social conditions in Gold Coast-Ghana do not approximate those of the West whose populations had centuries or millennia of development behind them by the nineteenth century, and differ profoundly from those of West Africa in historical background and in the relevant faculties, attitudes, and values.

Pincus' treatment of investment obscures the main problems and limitations of investment policy in LDCs. For instance he generally treats monetary investment as an indispensable major key to development, and also as an alternative to consumption. This approach ignores the major role of consumer goods (incentive goods) in LDCs as inducements to higher economic performance, and also as instruments for increasing the efficacy both of consumption and production (e.g., hardware, insecticides, and pesticides). The problems of worthwhile assessment of public investment are enhanced by the repercussions of both the collection and disbursement of funds on those important categories of direct investment (especially in agriculture) often ignored in conventional statistics, as well as the repercussions on the determinants of development treated parametrically in economic theory.

These are among the reasons why it is inappropriate to assume that the increase in monetary investment will necessarily promote a rise in incomes, let alone in living standards. An uncritical approach in itself tends to affect adversely the productivity of an investment program because the program is then unlikely to be designed to minimize its adverse and maximize its favorable repercussions.

Domestic factors necessarily play a subordinate role in a book on international economics. But here their treatment is quite inadequate. For instance the interaction of external and domestic influences is largely ignored or obscured in the discussion.

Among domestic factors Pincus stresses such matters as resistance to change by vested interests, property relations, landlordism, share cropping, market structure, and price distortions.[8]

8. In one place (*op. cit.*, p. 161) he refers to (unspecified) "social attitudes

Such references to basic social and property relations, vested interests, landlordism, market structure, traditional agriculture, that is to activities and relationships, rather than to people or persons, divert attention from such prime domestic determinants of economic achievement, as personal capacities, attitudes, motivations, and the customs and social institutions which reflect these. No one doubts that intellectual, artistic, and professional attainment reflects people's capacities, objectives, and interests. The same applies largely to economic achievement. Interest in material well-being and success, self-reliance, readiness to take note and advantage of economic opportunity and to provide for the future, sustained industry, thrift, a questioning turn of mind, and an experimental outlook, are major determinants of material progress. And the differences in these between ethnic groups and populations (including governments drawn from these populations) largely account for differences in economic attainment.

The significance of human resources is reflected within LDCs in the differences in economic attainment of ethnic groups; Chinese, Indians, and Malays in South East Asia; Jews, Armenians, and Arabs in the Near East; Indians and Africans in East Africa; Levantines and Africans in West Africa; Ibo and Hausa in Nigeria; Chinese, Lebanese, and West Indians in the Caribbean.

Both the relevance and significance of these differences and their antiquity are clear. On the other hand, the reasons for their emergence and the likelihood of their persistence are conjectural.

The institutional background very probably affects some of the relevant personal qualities and attitudes. Over most of Africa and Asia this background has over the ages subjected the individual more closely both to political authority and to the authority of traditional values and customs than in the West, thereby retarding the emergence of self-reliance, of the spirit of enquiry and experimentation, and often also of an interest in material progress. Policies which extend the subjection of the individual to authority are likely to retard economic advance. Conversely, extension of external contacts, especially with more advanced countries, is likely to undermine attitudes and mores most unfavorable to such advance.

Major economic policies pursued in LDCs, canvassed in the literature, and supported by Pincus, are either irrelevant to the development of the appropriate human resources and agents of ma-

that may be inconsistent with economic efficiency as conceived in the West"; the emphasis is always on "social" never "personal." The reference to Western conception of efficiency is obscure since the discussion deals with factors behind material progress.

terial progress, or even detrimental to it. Attempted correction for differences between private and social marginal cost, promotion of external economies, or removal from the land of allegedly surplus labor, do not affect the basic determinants of development. Accelerated industrialization, confiscation of property, extension of exchange controls (and presumably other unspecified controls) envisaged and applauded by Pincus generally obstruct material progress in the sense of a rise in incomes or living standards, by reinforcing the authoritarian methods, tradition and spirit long prevalent in most LDCs, by reducing people's external contacts, and by adversely affecting their economic incentives. These policies also exacerbate political tension by increasing state control over people's lives; they divert energy and ambition from economic life to political activity; and they divorce the composition of output from consumer demand with adverse effects on economic incentive, especially the inducement to enter the exchange economy. These issues are quite apart from the question of whence the governments derive the personnel for these ambitious policies.

Some of Pincus' ideas on domestic development are rather startling:

> Whether LDCs are well advised to adopt Marxist solutions . . . is not primarily an economic question. I have suggested above that very underdeveloped countries might well lose more than they gain economically from socialist control of the economy. This conclusion is much less certain for more advanced LDCs (for example, Turkey, Argentina). In such countries as these, development (under a predominantly market economy) has proceeded more slowly on the face of it than resources levels and skills would seem to allow. Draconian measures of expropriation, high taxation, and manpower reallocation might well raise growth rates sharply, after an initial shock.[9]

It is paradoxical to suggest that the removal of the fruits of economic activity should produce a beneficial psychic effect. The result is certain to be the opposite because effort and saving will appear pointless. Moreover people will divert their energies from work, saving, investment and enterprise to attempts to escape confiscation. Indeed, Pincus subsequently refers rather sarcastically to wealth owners of the LDCs who try to remove their assets to more serene climates.[1]

The domestic policies envisaged by Pincus plainly involve extensive state control over people's lives, and they thus greatly enhance inequalities of power between the rulers and the ruled. This result does not seem to perturb Pincus, who is critical only of

9. *Ibid.*, p. 164.
1. *Ibid.*, p. 343.

inequalities of incomes, or other easily (at least superficially easily) measurable magnitudes.

Because of his objections to material inequality Pincus favors large scale transfers from the rich countries of the West to LDCs (or rather their governments). The case for such a policy is apparently unaffected either by the policies of the recipient governments or by the faculties and attitudes of people in the recipient countries. Pincus regards substantial material inequality as iniquitous, and the moral case for its reduction as self-evident. However, worthwhile discussion of the implications of material inequality, and of the merits and costs of its elimination, requires examination of a whole range of issues neglected in this book.

The suggestion that inequality of incomes is inequitable implies a basic uniformity in living conditions and requirements. But there are wide international differences in physical and social conditions, modes of living, and thus requirements. The differences in physical requirements are obvious, but analogous differences apply also to social conditions. The relevance and implications of income differences depend greatly on the social context. Recipients of welfare payments in the United States have much higher incomes than most African chiefs or Indian landowners, yet the former, unlike the latter, usually feel themselves poor, and are normally so considered by their fellow men.

International income differences reflect differences in economic performance which in turn largely reflect differences in capacities, attitudes, institutions, and historical background. It is not surprising nor obviously inequitable that populations are materially poor who object to women's work outside the home; or who regard sentient animal life as inviolable and cattle as sacred; or who have a high leisure preference or little interest in material advance; or who have only very recently emerged from millennia of materially primitive conditions.

Equation of inequality with inequity implies that people are similar in all relevant respects except for differences in levels of income. If the only significant differences between people were in income levels, they would be largely accidental in origin and superficial in extent; and they would be relatively easy to eliminate. But the far-reaching and tenacious diversity in international conditions of life, and especially in human faculties, attitudes, motivations, and institutions, implies that international diversity and inequality cannot be eliminated or even substantially reduced by measures short of policies calling for the exercise of extensive powers over the activities and livelihood of different peoples, which, of course, implies vast inequalities of power. And the more diverse the conditions and the more far-reaching the differences behind economic attainment, the closer, more extensive and more rigorous the controls required to standardize material conditions. The diversity and inequality cannot be removed or even substantially reduced by a flow of external doles.

Although emphasizing the international inequality of incomes Pincus does not discuss the position and prospects of the poorest groups within the underdeveloped world, the desert peoples of the Sahara, the tribal populations of Africa, the aborigines of South America, South Asia, South East Asia, Australasia, Central Africa, and Latin America. These classes number at least tens of millions. Unfamiliarity apart, there are probably various reasons for the lack of reference to these groups in the development literature. They are politically ineffective and inarticulate; and reference to them would show up the hollowness of international comparisons of income, and also the diversity of conditions within the underdeveloped world.

Pincus bases the case for aid on moral grounds; and he considers that giving more is tantamount to doing better. But there is no ethical element in the transfer of taxpayers' money compulsorily collected from them because it is outside the area of volition and of choice.[2] Many of the contributors do not even know that they are contributing. (Persons who wish to support the LDCs can easily give money to governments, institutions, or individuals there.) Less fundamental but practically significant differences between voluntary charity and foreign aid include the possibility of adjusting voluntary contributions to the specific needs of particular groups. References to morality as the basis for foreign aid stir up suspicion in the LDCs, because people there who know about aid sense its essential differences from voluntary gifts, and rightly suspect references to its morality.

Although aid augments the resources of the recipient governments, it does not necessarily accelerate development because this process does not depend simply on the volume of financial resources. The outcome depends on the overall repercussions of aid in the recipient countries, including repercussions on major determinants of development treated parametrically in standard economic analysis; and these are often damaging and outweigh the inflow of the resources.

2. The argument is not that taxes are not necessary, or even desirable, but only that the payment of taxes has no moral element.

The receipt of aid necessarily increases the weight of the government in the economy and thereby enhances the concentration of power in these countries. This result is much reinforced by linking aid to the adoption of comprehensive central planning (whether real or fictitious planning) by the recipient governments, and to the payments difficulties of these countries, which promotes both inflationary policies and the establishment of closely controlled economies. For reasons already stated this result obstructs material progress.

It is not even certain that the flow of aid increases total investment. Some concomitants and repercussions of aid may reduce private investment and even encourage the flight of capital. Again quite often the expenditure made possible by foreign aid does not result in capital formation. And Pincus himself notes that it may serve to promote the financing of various military and nationalist enterprises.

It is thus unwarranted to assume axiomatically that aid necessarily increases the rate of development. Even when aid does not promote the development of the recipients, it may still reduce inequality by removing resources from the donors. But this argument is not often advanced.

There are many inconsistencies within the discussion of aid. For instance, when estimating the real cost of aid to donors, Pincus assumes that loans would be repaid,[3] but when urging donors to convert all aid into grants [4] he assumes, probably rightly, that the debtors would in any case default. Again he writes rather surprisingly, and without adducing any evidence, that the marginal return of capital is higher in the recipient than in donor countries,[5] while the contrary is implied elsewhere.[6]

To turn finally from substance to form, much of the presentation is inappropriate to a serious book. Here are two examples (among many):

> It is on the ethical plane that the present situation is scandalous. One-third of the world lives in comfort and two-thirds in misery. Yet no day spares us the edification of lectures by the prosperous North on the South's grievous economic sins.
>
> The proposition that current aid levels meet absorptive capacity requirements is at best, by stretching the point to its limit, an admission of Northern failure to cope with the development problem. In fact, it is something much uglier — a refusal to accept responsibility for others, because the South is weak and

3. *Op. cit.*, p. 314.
4. *Ibid.*, p. 357.
5. *Ibid.*, p. 315.
6. *Ibid.*, p. 355.

the North is strong. To make this ripe fish palatable to Northern consciences, policy makers sweeten it with foreign aid and spice it with self-help exhortations.[7]

IV

Johnson's book can be used as a textbook on applied international economics at almost any level. It will be required reading in international economics and development economics for many years.

The primary value of Pincus' book is as a useful introduction to the background of current political and public discussion on foreign aid, and as an uncritical presentation of prevailing views on foreign aid and the alleged guilt of the West.

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7. *Ibid.*, p. 353.