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Comments on Gustav Ranis' "Relative Prices in Planning for Economic Development"

by
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The main thesis of the Ranis paper is that the development of a newly independent economy should occur in two phases. (Mercifully, he has abjured the term "stages.") The first is a "growth-promoting" phase in which there is a "planned restructuring" of the economy toward import substitution. Resource use is determined by direct government allocation or by administered prices that have been distorted away from the levels that prevail in world markets or that would provide domestic market equilibrium. The second is an efficiency-promoting phase in which relative prices are adjusted toward their equilibrium levels, undoing the "artificial distortions" of the earlier phase and shifting the economy toward export expansion.

I find myself able to agree with exactly 50 per cent of this argument, fortunately the half that describes the direction in which most underdeveloped economies should be moving today. Development economists have been increasingly recognizing the need to go beyond the phase of import-substituting industrialization,[1] and the Ranis paper is useful in marshaling many of the arguments and in illustrating them with two of the most persuasive case histories.[2] The most important contribution of the paper may be the suggestion from the Korean case that saving rates can actually be increased by dismantling a system of controls partly established for the purpose of stimulating saving.[3]

I find myself unable to accept even the qualified endorsement Ranis bestows on the distorted-price phase: that it is "worth the price," but "only if it is geared to a gradual reduction of controls over time." My own position is that there is far less conflict than he implies between the objective of basic growth and the objective of efficiency, and that what conflict exists does not justify the kinds and magnitudes of price distortions typically adopted to encourage import substitution.

[1] See, for example, Santiago Macario, "Protectionism and Industrialization in Latin America," *Economic Bulletin for Latin America*, March 1964, pp. 61–101; United Nations Economic Commission for Latin America (Raul Prebisch), *Towards a Dynamic Development Policy for Latin America*, New York, 1963, esp. pp. 6–8, 67–78; Bela Balassa, "Integration and Resource Allocation in Latin America," 1966, mimeographed; John H. Power, "Industrialization in Pakistan: A Case of Frustrated Take-Off," *Pakistan Development Review*, Summer 1963; Power, "Import Substitution as an Industrialization Strategy," *Philippine Journal of Economics*, Second Semester, 1966, pp. 167–204; and Henry J. Bruton, "Productivity Growth in Latin America," *American Economic Review*, December 1967, pp. 1099–1116.

[2] In our common zeal for the merits of a market system we should be careful not to exaggerate. When Ranis tries to establish for Pakistan "a time-phased relationship between changes in agricultural price policy and in the willingness to adopt the burgeoning new technology" of the Green Revolution, I fear he risks crossing this line. Mexican wheat and International Rice Research Institute rice were not introduced into Pakistan on a commercial scale until 1965 and 1967, respectively. Growth of acreage was spectacular, and improvements in market conditions undoubtedly made the new varieties more attractive. However, the profitability of adoption would have been high even without these improvements, and we cannot contrast this fast adoption with some earlier period in which the technology was available to Pakistani farmers but was not being applied. (For profitability figures, see Lester R. Brown, *Seeds of Change*, New York, 1970, p. 42.)

[3] It is not really clear, however, why "distortions between the price of capital and of consumer goods may have led to high saving and low capital formation" in Argentina but "to relatively low saving and low capital formation" in Pakistan.

THE RELATIONSHIP OF PROBLEM AND POLICY

The Ranis paper offers three economic bases for a conflict between growth and efficiency as an economy emerges from a state of dependency—a lack of price-responsive entrepreneurs, a shortage of overhead facilities, and the immobility of resources and information.[4] The policy implications of these deficiencies would seem to be straightforward. The "infant entrepreneurial argument" is one that favors subsidizing and supporting entrepreneurship in general—through schools of business administration, special training programs in entrepreneurial skill and motivations, and the widespread availability of business credit (raised, if necessary, through taxation) at equilibrium interest rates. A lack of market information suggests that government should supply it directly or encourage cooperation among competing firms to seek it out. Resource immobility and deficient infrastructure justify government action to subsidize or supply basic overheads in transportation, communications, and education. What is striking, however, is the contrast between such neutral policies and the pricing and allocation policies which Ranis defends as necessary to overcome the

[4] Ranis cites a fourth, noneconomic justification for the system of distorted prices: "strong ideological reasons for not wanting to accept a market-oriented system" and for having "the public sector play a more extensive role." I do not think the economist must mutely bow in deference to such "reasons." The ideologies in question rarely seek ends which are unattainable through a fairly close adherence to equilibrium prices; rather, they often introduce dogmatic misperceptions of the relationship between means and ends. The job of the economist is not to take such misperceptions as given, or to rationalize them into "necessities," but to point out how ignoring opportunity costs can cripple the attainment of any set of economic objectives and to devise less costly ways of translating ideology into policy. For example, if the state must play "a more extensive role," the economist can make the case that the entrepreneurial gap is wider and the expected social return to investment is higher in the agricultural infrastructure than in automobile assembly.

The notion that adherence to ideologically prescribed means can itself be a source of national welfare parallels the argument that no forms of habitual consumption can be decried as "wasteful," since the individual's preference for them is itself an indication of their utility. Veblen's reaction seems apt: "The question is . . . not whether, under the existing circumstances of individual habit and social custom, a given expenditure conduces to the particular consumer's gratification or peace of mind; but whether, aside from acquired tastes and from the canons of usage and conventional decency, its result is a net gain in comfort or the fullness of life." This way of posing the question is even more appropriate in examining development policy, which can often gratify the politician or bureaucrat who calls the tune, while detracting from the comfort of the taxpayer, worker, or consumer who must pay the piper.

same obstacles. He lists many of the typical elements of "the import substitution syndrome": the undervaluing and rationing of foreign exchange; tariffs and import controls that are more stringent for consumer goods than for capital equipment; subsidized interest rates to favored borrowers; price controls and rationing for some basic material inputs; and measures to turn the internal terms of trade against agriculture. To this list we might add several more items: government inducements for higher urban wages; the escalation of tariff structures by degree of fabrication; the conferring of astronomical levels of effective protection; and a systematic tendency to underprice government services and products.

The net effect of these distorted price and allocation policies is to induce economic decisions which ignore the opportunity costs of resources, as represented by world prices and domestic factor availabilities. In an economically arbitrary manner these discriminatory policies favor the production of import substitutes over exports, of manufactured goods over agricultural commodities, and of consumer goods over capital goods; [5] they stimulate so wide an array of industries that few can attain an internationally competitive scale of production; they encourage the use of imported inputs in the domestic assembly of final goods; they favor capital-intensive techniques over labor-intensive ones; and they create bottlenecks in the provision of overhead services that provide neither guidance for the direction of further expansion nor the means by which such expansion can be financed.[6]

Ranis accurately describes the costs of maintaining this system as "patently large," so it should be abandoned once it has had time to "do its job." The system he describes, however, is never well suited to the job he has assigned it, is never accurately aimed at "the heart of the development problem."

[5] Power ("Industrialization," pp. 192–97) argues that the bias toward the production of consumption goods itself entails a bias toward consumption expenditure.

[6] Ranis at one point characterizes his early phase as one of "land- or raw material–based import substitution" as against later phases of labor-based and then skill-based "export substitution." If (as appears in the discussion of Korea) he means to contrast the characteristic inputs to exports, this distinction seems useful. The import-substitution process, however, is itself rarely "land or raw material" intensive but, as he says elsewhere, typically "capital- and import-intensive," and this defiance of the law of comparative advantage is a major source of its excessive cost.

Governments do not need distorted prices to induce them to stimulate entrepreneurship, to provide information, or to undertake overhead investments. Rather, increased supplies of entrepreneurship, information, and overhead capital can make their greatest contribution to development only if they support directly productive activities that are planned or established in close response to real opportunity costs in the economy. Many overhead services to production will realize that contribution only if they are rationed by prices which reflect their actual scarcities.

By contrast, the system of price distortions does "its job" by creating "larger than normal" profit opportunities in some lines but not in others. It stimulates entrepreneurship in automobile assembly but not in fertilizer production; it creates flows of information about the domestic market for tires made from imported rubber but not about the world market for glass made from domestic silicates; it provides railway lines to mammoth steel complexes but few dirt roads to village craftsmen and vegetable growers; it provides transportation so cheap that the mills can locate far from their sources of coal but close to their sources of import licenses.[7]

EFFICIENT AND INEFFICIENT GROWTH

The important contrast is not between growth and efficiency but between efficient growth and inefficient growth. Both theory and history suggest that efficient growth in the early phase of economic independence is (1) faster, because it wastes fewer of the limited resources currently available in the economy; and (2) more sustainable, because it saddles the future with fewer social structures that resist change and fewer economic structures that have to be scrapped, subsidized, or artificially supported.

As to the greater speed of efficient growth, the case histories of South Korea and Pakistan are suggestive but not conclusive, since the period of negligible per capita growth under distorted prices may—as Ranis

[7] See, for example, Edward S. Mason, *Economic Development in India and Pakistan*, Cambridge, Mass., September 1966, pp. 8–9; Anne O. Krueger, "Some Economic Costs of Exchange Control: The Turkish Case," *Journal of Political Economy*, October 1966; John A. King, Jr., "Colombia: Steel," Case 30 in *Economic Development Projects and Their Appraisal*, Baltimore, 1967, pp. 505–27; and Alan Carlin, "Indian Transportation: A Sectoral Approach to Development Constraints," *Journal of Development Studies*, July, 1967.

implies—have laid some essential groundwork for rapid growth when price distortions were finally reduced. Fortunately, there are many examples of underdeveloped economies that have grown continuously and rapidly in the postwar years in a single phase of broad participation in the world market—the Central American republics, the Ivory Coast, Lebanon, Malaysia, Singapore, Hong Kong, and, to a great extent, Mexico and Peru.[8] Both Dudley Seers and Barend de Vries have provided cross-sectional evaluations of the strategy of inward-directed growth through distorted prices, largely for the Latin American economies, and have shown that only the largest of these have been able to maintain respectable aggregate growth. Thus, the South American pattern of development—what Prebisch has come to lament as "industrialization in watertight compartments"—has not taken Brazil, with a broad spectrum of resources and a sizable domestic market, nearly so far from the exploitation of comparative advantage and economies of scale as it has taken Paraguay and Uruguay.[9] Estimates of Chile's loss of current GNP through allocative distortions run from 2.5 per cent (Harberger) to 14 per cent (Balassa's upper limit).[10]

[8] The list includes none of the largest of the underdeveloped economies—not because the policy of growth through trade at world prices has failed for them, but because few (if any) have tried it. Reaching farther back into history, there are many explanations of the remarkable development of Japan, but it seems difficult to explain the pattern of that development without including the fact that for most of the Meiji period Japan was forbidden by treaty from levying import duties of more than 5 per cent ad valorem (See, for example, W. W. Lockwood, *The Economic Development of Japan*, Princeton, 1954, p. 539) Individual enterprises were established and temporarily subsidized by the government, but the main thrust of "structural change" took place in the context of world prices

[9] Barend A. de Vries, "Importance of Size for the Orientation of Economic Policy," in David Krivine, ed., *Fiscal and Monetary Problems in Developing States*, New York, 1967, pp. 309–23. and Dudley Seers, "The Stages of Economic Development of a Primary Producer in the Middle of the Twentieth Century," *Economic Bulletin of Ghana*, 1963, pp. 57–69. This kind of reasoning and evidence tends to support Ranis's assertion that "the relative importance of the exchange rate is much greater in the case of a small economy than in that of a large one." Such assertions, however, should not overlook the effect of the distorted price policy in reducing the import share of GNP but making it more strategic for the continued functioning of the economy. The smaller tail is often more able to wag the dog. Witness, for example, stories of Pakistani coal mines being forced to close temporarily for lack of imported safety lamps, or 40 per cent of Indian tractors being out of commission in 1966 for lack of imported spare parts. On the latter, see Brown, *Seeds*, p. 60.

[10] Balassa, "Integration," pp. 3–8. Arnold C. Harberger, "Using the Resources at Hand More Effectively," *American Economic Review*, May 1958, pp. 134–55. Assume these resources to have been saved rather than wasted. From an historical (but

Inefficient growth is less sustainable than efficient growth because it achieves not only "a broadening of the resources base, both human and material," but also embeds that base in structures that continue to delay and inhibit the transition to a more efficient pattern of production. On the human side, entrepreneurs trained at "chasing slips of paper and subverting the control system" may bear no special qualification for chasing customers in world markets or subverting the mindless application of Western technology to domestic production.[11] "Entrenched" industrial and bureaucratic interests may use all their accumulated power to sabotage any tendency toward market rationing at equilibrium prices.

There is little evidence that the distorted price system serves to transform institutions "in directions which accommodate rather than obstruct change." All too often the corollary of "structural change" through distorted prices is structural resistance to restoring an efficient pattern of production. Significantly, the dramatic decontrol measures in South Korea and Pakistan were both decreed by strong governments that were born in military coups and had secure power bases independent of the bureaucratic and industrial interests.[12]

On the material side, the most pernicious legacy of an inefficient pattern of investment is not the abandoned cannery or the broad highway reverting to jungle, widespread though such examples may be. Such investments can be written off to experience while the economy

inefficient) Chilean capital-output ratio of 3.2, we can crudely calculate that the growth rate could have been higher by 0.8 to 4.4 per cent. Bruton, "Productivity," estimates "residuals" (annual growth rates of productivity) during the postwar period which are respectable for Mexico (above 2 per cent), low for Brazil and Colombia (about 1½ per cent), negligible for Chile, and negative for Argentina.

[11] Presumably the spectacular business success of Captain Gohar Ayub in Pakistan over the period 1963–68—in automotive assembly, canning, and the distribution of imported tractors—was not entirely due to the applicability of his military training to entrepreneurship but bore some relationship to the fact that he was the son of the president of the republic.

[12] It might be unfair to apply to a normative "phase" theory one of Simon Kuznets's requirements for a descriptive "stage" theory—that it identify "the major processes in the preceding stage that complete it and, with the usual qualifications for exogenous factors, make the next . . . stage highly probable" ("Notes on the Take-Off," in W. W. Rostow, ed., *The Economics of Take-Off into Sustained Growth*, New York, 1963, p. 24). If, however, as Ranis implies, movement out of the distorted-price phase is a requirement for its validity, then any useful normative theory must establish that the impetus for the transition is something more endogenous to the economy than the *deus ex machina* of a takeover by strong-willed and well-advised military leaders.

goes forward into more promising lines of production. Nor is it the government enterprise which, after a decade of operations, enjoys a profit rate only half that of comparable private firms. Rather, the heaviest burden on the future is created when inefficient enterprises must have their operating costs subsidized directly by the government (like the ubiquitous national airlines) or indirectly by the economy (like the Pakistani industries which, well into the "efficient" phase of economic development, were consuming raw materials worth more on world markets than the final goods they were producing).[13] An additional burden on the future results when new inefficient enterprises are created primarily to justify an original inefficient enterprise by providing its inputs (e.g., the parts for domestically assembled automobiles) or by purchasing its outputs (e.g., electricity or steel for which there is inadequate domestic demand).[14] While the cases of direct subsidization are more blatant and entail the extra cost of dissipating scarce government revenues, the many forms of indirect subsidization may ultimately do more to hamstring the growth potential of the economy.

CONCLUSION

I do not think we need to be so relative in our advocacy of economic efficiency as Ranis implies. I think it is perfectly possible to devise a

[13] While the extent of "negative value added" in Pakistan reported by Soligo and Stern, based on highly indirect evidence, was probably exaggerated, more detailed investigations still find examples of the phenomenon. Examples are not confined to import-substituting industries but spread to the export sector—e.g., cotton textiles in Pakistan, cocoa butter in Ghana—when export preferences are granted to manufacturing but not to agriculture (See, for example, Richard Mallon, "Export Policy in Pakistan," *Pakistan Development Review*, Spring 1966, pp 58–79; and Elliot J. Berg, "Structural Transformation vs Gradualism Recent Economic Development in Ghana and the Ivory Coast," 1969, azographed.) Of more quantitative importance may be the heavy outlays in domestic resources to save insignificant —but positive—amounts of foreign exchange.

[14] Specific examples of "linkages" used to subsidize inefficiency include the progressive "content-protection" regulations applied to automobile assembly in Latin America; action of the colonial government of Uganda to subsidize an abortive industrial estate near the site of the Owen Falls Dam; and tax exemptions granted by the Colombian government to users of steel from the Paz del Rio mill. See, for example, Leland L. Johnson, "Problems of Import Substitution: The Chilean Automobile Industry," *Economic Development and Cultural Change*, January 1967, pp. 202–16; Walter Elkan and Gail G. Willson, "The Impact of the Owen Falls Hydro-Electric Project on the Economy of Uganda," *Journal of Development Studies*, July 1967, pp. 387–404; and Richard C. Porter, "The Effectiveness of Tax Exemption in Colombia," 1969, multilithed.

general defense of the equilibrium exchange rate as the basic device for rationing foreign exchange and an equilibrium interest rate as the basic device for rationing capital and for price rationing in general as opposed to quantitative restrictions. I think it is possible to phrase that defense in ways that are independent "of the type of economy we are talking about" and the "phase of development" in which that economy finds itself, one which would be as relevant for Burma as for the United States. Equilibrium prices do not imply laissez faire, and such a defense need not preclude a substantial developmental role for government—in the areas of saving, investing in infrastructure, stimulating entrepreneurship, exercising monopolistic power in particular world markets, nurturing truly infant industries, regulating aggregate demand, and insuring some appropriate tradeoff between equity and the speed and efficiency of the growth process.[15] Nor need that defense deny that an efficient pattern of growth will entail substantial and continuing import substitution, particularly for a large economy. It should even recognize that administrative obstacles or distributional considerations may force a solution in which some individual prices are taxed or subsidized to draw them away from world or domestic equilibrium levels. But a general statement of development policy would hold that efficiency is always "relevant" and that no rational pattern of divergences from equilibrium prices would in any way resemble the systematic distortions and gross inefficiences typically introduced in the name of "structural change" through import substitution during the "growth-promoting phase" of economic development.

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There are a number of disagreements with Gustav Ranis's presentation of the problem but, to vary the French phrase, *l'accord vient en lisant*. In fact the paper seems to be written by two people. There is Ranis the statesman and apologist, the understanding father confessor. And then there is Ranis the economist, who really knows better, who knows that in fact *tout comprendre n'est pas tout pardonner,* and who realizes that the cost of nonsense is just too high. In a discussion, it is proper to stress the disagreements even though in fact the agreements dominate. The disagreements diminish with each section.

First, I regret that Ranis has in a sense prejudiced his discussion by equating a market-oriented with a capitalist economy, and by seeming to suggest that only in these do prices have a proper role. Even if we had a centrally planned economy, prices would of course be an essential planning tool—*vide* "Liebermanism"—though they would (ideally) reflect the planners' rather than consumers' preferences. Even there they would (ideally) reflect true scarcities of factors, which of course are affected by the planners' preferences for particular output mixes.

Prices are not an ideological phenomenon—though many countries believe they are, and act as if they could ignore them. No priceless economy of any complexity exists. What happens depends on what prices happen to be, and if they are irrational, irrational things happen. Why should the absence of a "large number of entrepreneurs sensitive to price and profit signals" make any difference? (Ranis). For one class of entrepreneurs, farmers, it is by now reasonably well established that they do react to price signals. But suppose there are no entrepreneurs, and the whole manufacturing and agricultural sector is controlled by the government. How would a planner decide upon a steel or textile mill or anything else without reference to cost and prices? And if he wants to increase the amount of goods available to the economy—whether for private consumption or public investment or education or social overhead—he still would want to avoid waste. How could that be done without prices?

Let us also agree that the conditions of Pareto–optimality in the static sense—are not entirely relevant, and in the dynamic sense not easily achieved. But let us then declare a moratorium on the necessity of such stringent conditions, let us forget the very artificial and indeed pernicious distinction between prices as an allocation and prices as a growth-promoting device, and let us settle for practical purposes on the necessity to use prices and to have prices reasonably (not perfectly) realistic (as defined above).

Ranis states:

> the relevance of the price system as an essential instrument to ensure optimality requires that there exist no economic necessity, e.g., because of scale or other reasons for government to play a substantial role in the economy's directly productive areas, and moreover, that there exist no overriding non-economic or ideological "necessity" to have the public sector play a more extensive role. Thirdly, we must assume the relatively full and free flow of information and resources, i.e., the absence of pronounced institutional constraints.

I find this almost totally unacceptable even where it is correct.

1. The supposed economic necessity for government to play a role refers, among others, presumably to economics of the public utility type, where "natural monopolies" make marginal cost pricing inapplicable. Now from a planning standpoint which deals with *future* investments, variable and fixed and hence marginal and total cost are the same anyway. But surely, the failure of marginal cost pricing (as

applied to a particular existing project) to give correct answers hardly justifies dismissing the use of prices as a planning tool. There are still more or less rational ways to do business.

2. Ditto for having a larger or smaller public sector. The real point is that "ideology" has been used to "subsidize,"—i.e., to justify—an uneconomic allocation, or to put it differently either (a) to justify the eating up of one's capital; and/or (b) to tax the productive sectors (usually agriculture) more and more in favor of supposed "dynamic" sectors or "socially desirable" ends. The fact, however, is, as J. R. Hicks remarked a long time ago, that the satisfaction of social needs quickly runs into the barrier of insufficient productivity. Or, as I have desperately tried to put it to a minister of finance: I understand that politics has priority over economics. I do *not* understand how you propose to meet political ends without economic means. Prices are nonideological, and the preference of ideology over economics is a confusion of ends and means.

Since these lines were written—and I have stressed this point for many years—*Le Monde* has carried a report of Le Duan's prescription for North Vietnamese planning. Le Duan stresses the importance of productivity and the weaknesses in project management (*gestion*). He stresses that there must be planning, of course, but *'dans quelle mesure utiliser les rapports de marché, et les leviers du crédit, des prix, des salaires, du profit?"*[1] I could go on quoting the first secretary of the North Vietnamese Communist party as a crown witness for my point of view. It suffices to stress that it is completely wrong to say, as Ranis does, that "the society must be practically and ideologically

[1] Jacques Decornoy, "M. Le Duan met l'accent sur 'la révolution technique' et la nécessité de rationaliser l'economie," *Le Monde* (Paris), June 21–22, 1970, p. 5. Decornoy summarizes with numerous quotations a 200-page North Vietnamese document. It is somewhat embarrassing for a capitalist American to quote the Chief Enemy. But I can think of nothing better to show that economic development is "really" a matter of economics and that prices belong to the *faits recalcitrants et têtus* of the economy than to do so. Since I have several times referred to the recalcitrant nature of economic reality and since this is a highly idiosyncratic use of the word, I wonder whether part of my royalties have come from Hanoi!

Le Duan's willingness to analyze his situation so objectively and to blame the neglect of economics rather than the Central Intelligence Agency or even the bombing for his troubles explains perhaps why North Vietnam has been able to cause us so much trouble! It would certainly be better for the United States if he preferred ideology to economics!

ready to accept the capitalist system as a driving force." I am aware that political scientists sometimes argue this way. But the problem is one of efficiency and not ideology; it is not whether an enterprise should be public or private, but whether it produces a net output or wastes resources.

3. Finally, the lack of information is desperately real. But the conclusion I draw is that planners must still use prices the best way they can. The presence of "institutional constraints" explains why things go wrong, not that one can do without prices.

Ranis has put his finger on an important shortcoming of planning models in general: the absence of government in influencing allocation. But this means not that prices are less important, but only that the models are irrelevant precisely in situations in which the government is given a crucial role in determining *how* resources are to be used against how many are to be used.

I do not therefore see just what Ranis is driving at in his implied assertion that an efficient utilization of available resources is not in fact "the" (his quotes) major social problem, particularly in the face of a "frequently stagnant colonial agrarian situation," and that such role as relative prices has does not capture the "essence" of the development problem; which is "basically . . . the achievement of structural change via a broadening of the resources base, both human and material. The basic question . . . is not how to allocate given resources more efficiently, but how to introduce technological change . . . ," etc. Precisely. Having defined the object of development to make sure that as the result of one's resource allocation I come out with more resources to allocate rather than less, and with more and better choices (in my *Planning Without Facts*) and being a student of Schumpeter, I have never understood the problem of resource allocation in a dynamic context to be anything else. The dichotomy made by Ranis does not exist (except possibly on the rarified level of purest mathematical static theory), any more than the idea that prices have something to do exclusively with a market economy. Ranis's section I, in other words, is a red herring.

It is a very dangerous red herring indeed. Perhaps Ranis has been seduced by the theory of stages. He discusses in his section II the import substitution phase through which newly independent countries are "likely" to pass. But again Ranis seems to me to contradict himself. Prices cannot be expected to create the environment for growth; therefore planners may have to use protection and subsidies to make production profitable. But this simply means that the price system is rigged in favor of certain activities. It is a kind of primitive shadow-pricing policy.

Countries try to get rid of colonial production patterns—and more power to them. But the colonial patterns were often (not always) maintained precisely by rigged prices—the French system of paying higher than world market prices is perhaps the best example—and rigged markets—again the French have offered protected markets to their colonies. It should be self-evident that underdeveloped countries having scarce resources must rationally allocate them to achieve their ends. Ranis's account shows that in fact the opposite has happened.

How did it happen? Ranis refers to Prebisch, and far be it from me to defend him. But those of us who had thought to bypass the pricing mechanism in favor of continuous subsidies or of decision making in physical terms bear a considerable guilt. We complain about techniques deemed too capital-intensive, yet rig low interest rates; we complain about misusing scarce foreign exchange, yet rig overvalued exchange rates; we complain about the absence of entrepreneurs, and let a bureaucrat produce steel with no economic sanctions and virtually unlimited access to the budget. We create institutions to break bottlenecks, and then make it impossible for them to achieve their end because we set up an irrational price system. To add insult to injury, this sort of nonsense is sometimes defended by reference to "learning by doing." Yet those of our colleagues who developed this idea never had in mind the abuse, any more than Arthur Lewis's *Industrialization of the Gold Coast* can possibly be used to defend what passes as an import substitution policy.

In short it is precisely the attempt to bypass prices as a planning device—or to console oneself perhaps that they are the dual of an input-output table—which has led to the absurd situation so well described by Ranis. There has been no "learning by doing" because the curriculum has been irrelevant in the absence of decent prices. Nor has there in all likelihood been any import saving.

Thus Ranis is obviously right that if the "hothouse" atmosphere of controls and wrong prices (leading to windfall profits instead of output), etc., is not abandoned, entrepreneurs cannot learn their business. But it remains quite unclear just how the creation of the hothouse atmosphere did any good in the first place. There is a Rasputin-like quality about the argument: the more you sin, the greater the salvation. But it really makes no more sense in economics than in theology, and it can ruin economies as well as empires, ministers of finance and planning as well as czars.

Ranis describes well what happens: ". . . under the previous regime, public and [very rarely—W.F.S.] large-scale private enterprises were the beneficiaries in response to the actual or assumed shortage of domestic entrepreneurship. . . ." Precisely. In the abstract, the "import substitution phase" is seen as a necessary period of economic violence, as it were, to break with the past and establish a base for the future which the next step (so well documented by Ranis as a substitution of price signals for direct controls) is to rationalize.

But in *actuality* what has happened and what Ranis has described is really nothing of the sort. If the colonial policies, as in British West Africa, have induced the development of a cocoa industry by small- and medium-sized farmers, it was to the benefit of the future country—and the absence of unjustifiable subsidies, of rigged prices, monopolies, milking of budgets and the rest, indeed laid a sound foundation for later stages. Where colonial policies were policies of rigged prices and guaranteed markets, of subsidies and exploitation, it did nothing of the kind. The policies of import substitution as practiced—not as envisaged by W. A. Lewis or Hirschmann—in fact continued the colonial pattern of exploitation, of freezing the economy in inefficient patterns, of preventing the emergence of entrepreneurs, whether private or public. What difference that the color and nationality of the exploiter changed? What difference the socialist rhetoric to which models of indifferent academic interest give some respectability? Nkrumah went through over $1.75 billion. It is impossible not to do *some* good while spending this kind of money. Yet the present Ghanaian government is after ten years of Nkrumah's "socialism" without foreign reserves, with a foreign debt of $1 billion, without working capital, with a dubious endowment of fixed real capital, and has to undo the damage of years, only to meet with snide sniper attacks.

Sukharno did the seemingly impossible: He did eat up practically all of his patrimony without noticeable benefits. In Latin America, the industrialization policies have aggravated revolutionary situations. The periods of import substitution had in fact not done what they were, theoretically, supposed to do, and they could not.

So my conclusion is that the very establishment of a base for growth, of an incipient entrepreneurial group—whether private or governmental is irrelevant—requires sound price policies. (Needless to say it requires a lot more than that, but this conference deals with price problems). So I agree with Ranis that the problem is to promote "growth by undoing the artificial distortions while preserving the gains of the earlier period," while insisting that if there were any gains at all in the "import substitution phase" they were accidental and not inherent in past policies.

Perhaps it would be good to add more specific uses of prices in planning. In project evaluation, the "correct" prices are evidently important. No great sophistication is needed. The truth is that investments will produce growth only if they are "really" profitable and if they do not swallow up resources as hidden or open subsidies. Hence it becomes important to estimate output prices and cost, but also timing problems, tax revenues and resources required, cash flows, etc. This links the projects also to budgets and hence to savings which, in most countries, are prominently made a task of the government. If the prices are reasonably correct, we can evaluate the project. If they are rigged by tariffs or subsidies, the project can be made to look good, but by working out the budgetary implications there is a check on whether the evaluation was reasonable. It is possible to make any individual project look good. It is not possible to make all of them look good at the same time.

Practically speaking it means that one should try to overestimate cost and underestimate revenues, and that one should be careful about when to accede to direct or indirect subsidies which hurt the budget and are therefore at the expense of alternate investments and/or other uses. It is precisely this neglect that leads in Ranis's import substitution phase to such waste.

Prices are not only signals. There must be a discipline. If prices are improper, say for "social" reasons, it will show in the budget. Example:

In Tunisia the railway proposes an economic tariff. The government may, for perfectly good reasons, prefer a different tariff and agree to compensate the railway. It is a legitimate use of governmental power. But the economist must point out that if the subsidy had been eliminated, savings would have been bigger (though perhaps by less than the subsidy reduction).

Or, if a steel mill gets the right price it will operate efficiently. If its prices are kept high, there will be a cost to other enterprises and/or the government. If it is too low, there will be subsidies, or else there will be borrowing for the wrong purposes. Instead of using resources to augment resources, instead of finding new resources, the wrong prices invariably reduce present and future resources. This is true no matter what the stage of development of the economy.

Prices may change over time. Hence if there is a lag between inputs and outputs, input prices must be current—I leave aside the problem of replacement cost—and output prices must be the best guess of the future. Again the stage of development is irrelevant. Some of the Ghanaian factories can be salvaged. As for the others, if the earth swallowed them, it would be the best thing that could happen. The annual operating subsidies in some cases I know of would pay for whole new factories, with a greater output and more employment!

I do not feel it necessary to discuss Ranis's last section. There is complete agreement as well as the awareness, shared by Ranis I am sure, that much more than prices are involved in the Korean or Pakistani performance, or that, for that matter, the last word on these experiences has not yet been spoken. I conclude that the distinction made by Ranis between growth-promoting and efficiency-promoting functions of prices is a red herring from the standpoint of development policy (whatever may be said for it from a purely theoretical standpoint). No one in his right mind has ever claimed that correct prices will automatically lead to development. Such a unicausal proposition is undoubtedly much better than explaining growth by the method of swaddling babies, but still insufficient. But there is no doubt in my mind that the ignorance of how prices work and the attempt to bypass them have in fact caused the very difficulties which are referred to as neocolonialism and which are much more the fault of domestic leaders of the Nkrumah-Sukharno type and their intellectual tutors than of such foreign scapegoats as are fashionable at the moment.

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