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THE PRECONDITIONS OF MARKET-LED DEVELOPMENT AND THEIR IMPLICATIONS FOR A.I.D. PROGRAMMING

W. Donald Bowles

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PREFACE

This paper is intended as a contribution to the continuing discussion in development circles of the purposes and possibilities of development assistance. We take a look at where it all began for those of us in the developed West--Great Britain of the pre-industrialization period. The story in one sense is very old, and at some risk we condense several centuries into a few pages. Emphasis is on the period prior to the Industrial Revolution (roughly from the end of the 16th into the second half of the 18th century) because we are looking for the conditions which caused it, and which made it successful.

This story is at the same time new because, as historians tell us, each succeeding generation finds new "lessons" in history, lessons pertinent to the needs and questions of that generation. We ask this question: what is there in this period of history which helps us to understand the development needs and potentials of what is called the Third World today, and what might that period tell us about the usefulness of development assistance in light of these lessons of history? After noting the important preconditions of British industrialization, we then examine a few of the ways in which the conditions of development in less-developed countries (LDCs) today differ significantly from the preconditions of British industrialization. Finally, we explore the implications of their absence for A.I.D. programming today.

Is the story we tell of British industrialization too simple? Yes. Are important ingredients left out? Yes. Are there competing explanations? Yes, in part or in whole (e.g., Marx). Despite these shortcomings, are there lessons here? Yes.

The single, over-arching "truth" evident in this story is that the market-based Industrial Revolution was a Western phenomenon, rooted in centuries of Western culture, and peculiar to Western Europe. Today, old style state planning and management have been discredited. Yet, it would be just as wrong today to urge market models on LDCs as it was to encourage them in state planning 30 years ago. Both models flow from economic, social, political, cultural, and ideological conditions in the West which have evolved over centuries. The general conclusion this suggests is that the role of outside donors is to help the LDCs find their own ways toward development. More specifically, donors can help LDCs to overcome the time gap required for creation of institutions supporting market-led development, and it can help prevent the poorest from bearing the full cost of the structural and institutional shifts which will accompany market-led development.

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> It is not more than seventy or eighty years since, that a few humble mechanics in Lanarkshire, distinguished by scarcely anything more than mechanical ingenuity and perseverance of character, succeeded in forming a few, but important mechanical combinations, the effect of which has been to revolutionize the whole of British society, and to influence, in a marked degree, the progress of civilization in every quarter of the globe.
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> A Member of the Manchester Athenaeum, 1844 [Perkin vi].

Both the drama and significance of the Western pattern of industrialization and development of the last 200 years are captured in the statement of the member of the Manchester Athenaeum of 1844. The lessons we draw from that experience exert a powerful influence on the ways we think about economic development[1] throughout the world today.

Economic history can be reduced to a few sentences. It took hundreds of thousands of years to learn to grow crops and domesticate livestock, and thereby, during the Neolithic Revolution, to raise production above the level of subsistence. It took another ten thousand years to make a comparable breakthrough--industrialization and its accompanying improvements in agricultural production. Over the next two hundred years--our two hundred years--we leapt to atomic power, automation, and solar voyages. With some exception, we can now choose our technical advances, and barring war or environmental collapse humankind can make the future. For the most part, the story of modern development of the last 500 years is rooted in Western Europe.

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[1]A distinction is usually made between growth, an increase in national output, and development, an increase in national output which occurs with structural, social and political change such that growth becomes self-sustaining. Our concern here is with development.

Today about one billion people can be classified as "down and out," on the edge of starvation, routinely ill, with no productive employment. They live in less-developed countries (LDCs) which suffer from weak or negative economic growth. Three-fourths of all people live outside the developed world. What is there in the Western story to help us understand development today?

Our purpose here is three-fold.

-- First, we highlight the "preconditions" of the Western model as seen in the British experience. Emphasis is on the period prior to the Industrial Revolution because we are looking for the conditions which caused it. Many of these changes are captured by the phrase "merchant capitalism," a period roughly from the end of the 16th into the second half of the 18th century, more than two-and-one-half centuries.

-- Second, we compare major features of LDCs with the most important pre-conditions of market-led development exemplified by the British process.

-- Finally, we look at the programming implications for A.I.D. of this comparison. In brief, we examine the sources of the Industrial Revolution in Britain, and an understanding of the relevance of that experience to LDCs today.[a]

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[a]This discussion is based largely on the sources indicated in the bibliography. These are standard sources in Western literature. Each scholar is eminent, and two (Kuznets and Myrdal) are Nobel Laureates. For the reader wanting a quick review, the following are most important: Landes ch. 1 and concluding chapter; Perkin chs. 1 and 2; Kuznets chs. 1 and 8-10; North and Thomas.

Preconditions of Development in Great Britain

The Industrial Revolution consisted of three kinds of material changes: substitution of mechanical devices for human skills, substitution of inanimate power (largely steam) for human and animal strength, and sharply improved industrial processes for obtaining and processing raw materials (mainly in the metallurgical and chemical industries). The single unifying theme was change which led to further change, a process both cumulative and self-sustaining. These material changes were dependent on complex economic, social, political, and cultural changes, all of which we have come to label as modernization.[3]

Change occurred in Europe first, and within Europe, first in Britain [Landes 12ff]. While a list of causative factors may be argued, the following seven factors would probably be on most lists.

1. Relatively high per capita income. Europe (but especially Britain) had already proceeded economically far beyond minimal subsistence. In 20th century equivalents, per capita incomes in England and Wales at the end of the 17th century were about 70 pounds in 1700 and 100 pounds fifty years later. Average income in the early 1960s in Nigeria was about 30 pounds. Only LDCs which were semi-industrialized had incomes comparable to the British levels (e.g., Brazil and Mexico in the 1960s).[4] High incomes, of course, rested on high productivity

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[3]In Landes' view [Landes 6], modernization consists of "...such developments as urbanization (the concentration of the population in cities that serve as nodes of industrial production, administration, and intellectual and artistic activity); a sharp reduction in both death rates and birth rates from traditional levels (the so-called demographic transition); the establishment of an effective, fairly centralized bureaucratic government; the creation of an educational system capable of training and socializing the children of the society to a level compatible with their capacities and best contemporary knowledge; and of course, the acquisition of the ability and means to use an up-to-date technology." This view is largely compatible with Gunnar Myrdal's view of modernization. See his Asian Drama (New York: Pantheon, 1971), pp. 57-69.

[4]Based on Phyllis Dean, The First Industrial Revolution (Cambridge: Cambridge Univ. Press, 1965), p. 6 [Landes 13]. Landes argues (pp. 13-14) that "Western Europe... was already rich before the Industrial Revolution--rich by comparison with other parts of the world of that day and with the pre-industrial world of today. This wealth was the product of centuries of slow accumulation, based in turn on investment, the

which depended on the application of inanimate energy and machines in production. In turn, the extraordinarily high rate of adoption of new technology rested on the creation and stability of institutions supporting self-sustaining economic growth.

2. Wide scope and effectiveness of private economic enterprise. Britain was composed of many competing power groups (unlike the monolithic societies of Islam, for example), and the firm and secure place of private enterprise rested on the creation of specific institutional arrangements governing production and distribution [Landes 16ff]. The concept of property came to mean the full vesting of all rights in the possessor, who was free to dispose of it or use it at will. There was an increasing sense of security in property rights which reinforced the significance of property itself. Finally, the use of explicit contracts to define relationships reduced uncertainty about the meaning of agreements and provided the kind of determinacy necessary for commerce and industry, and these contracts were enforced by the growing authority of the new nation-state.

3. Growing personal status of the peasantry. This occurred for several reasons [Landes 18]. First, the Black Death and later epidemics reduced the supply of labor relative to land and capital, and employers had to pay more to attract and hold workers. Second, the long-term debt of the peasantry who held leases was eased in real terms by the inflation of the 16th century. Third, the emergence of prosperous cities and towns provided both freedom and employment for those who escaped the rigors of country life. Concurrently, this created a market for cash crops which in turn reduced personal bonds and gave the peasant a degree of economic independence. All of these developments contributed to the spread of commercial manufacturing from town to the countryside.

4. Changed philosophic view toward nature. One element of this change was rationality, the growing and routine association of ends with means in the scientific sense, the antithesis of superstition and magic. The other has been called the "Faustian sense of mastery over man and nature" [Landes 21]. A case can be made that this rationality was apparent in the "choice" of lower birth rates in Western Europe than in other parts of the

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appropriation of extra-European resources and labor, and substantial technological progress, not only in the production of material goods, but in the organization and financing of their exchange and distribution."

world.[5] The "Faustian ethic," reflected both the waning of Church power and growing materialism. It was the Scientific Revolution in the early modern period, of course, which not only discredited some aspects of organized religious thought, but that challenged all conventional wisdom of the time.

5. Emergence of science as a major force in society. There is considerable evidence that science flourished in Europe, but especially in Britain, because it grew in nation-states, and competition among such powers stimulated science. The source of the competition was the policy then ascendent in Europe of mercantilism in which the state controlled and manipulated the economy for its own advantage. Mercantilism was heavily pragmatic, and consisted less of a body of doctrine than a series of state responses to particular circumstances. As such, mercantilism too reflected growing rationality as it became the dominating organizing force in society of the time.[6] In effect, science became an object of positive state policy in Britain.

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[5]"European birth rates before industrialization were well below the biological maximum--significantly lower, for example, than the rates of today's pre-industrial societies before and even after the introduction of programs of family planning. Moreover, ... variations in birth rates ... seem to have been closely related to the ratio of resources to population. This is evidence presumably of self-restraint--an effort to restrict commitments to means--and as such is an excellent example of rationality in a particularly crucial and sensitive area of life" [Landes 22]. Landes notes that Asian peasants with a large family are following a rational policy, the idea being that large numbers of children are necessary to ensure survival of some in the face of high death rates. He suggests, however, that this merely displaces the question. "Mortality rates were presumably just as high in western Europe in the pre-industrial period as in contemporary Asia. Why did the European peasant not feel this need?"

[6]"Its principles were modelled on those propounded for the natural sciences: the careful accumulation of data, the use of inductive reasoning, the pursuit of the economical explanation, the effort to find a surrogate for the replicated experiment by the use of explicit international comparisons. ... All of this gave Europe a tremendous advantage in the invention and adoption of new technology. The will to mastery, the rational approach to problems that we call the scientific method, the competition for wealth and power--together these broke down the resistance of inherited ways and made of change a positive good. Nothing--not pride, nor honor, nor authority, nor credulity--could stand in the face of these new values" [Landes 32-33].

The result was a rate of invention and new technology adoptions exceeding that in the rest of Europe.

6. Establishment of colonies. European, but especially British, development was characterized by what has been called the "element of differential violence--violence, first, in the sense of destructive incursions; and second, in the sense of dominion and exploitation of one society by another" [Landes 33]. From the 11th century on, Europe began thrusting out. Its superior technology enabled distant exploitation and colonization. What did this mean economically? One school of thought suggests that the British Industrial Revolution was accomplished on the backs of Indian peasants. An opposing school downplays the importance of colonies to colonizers, and some even suggest that colonization brought advantages to those colonized. For British development, India was important while Africa was marginal. In general, there is no evidence that mother countries would not have developed without imperialism.

7. British society and the role of landed interests. Underlying all other explanations of British development is the nature and structure of English society. The history of Britain reveals that a simple economic explanation of economic growth is only a weak and partial explanation. The old society which gave birth to the Industrial Revolution was an open aristocracy based on property and patronage [Perkin 17ff]. Income inequality was great, but its effects were softened by a wide diffusion of wealth. There were no classes as that term is understood today (a 19th Century invention). Instead, there was an endless array of minutely graded different groups.[7] The density of this continuum is very important. Some 40 different status levels have been described. The distinction between "gentlemen" and "common people" was perhaps the most important "horizontal cleavage" [Perkin 24], though it bore almost no relationship to economic status.[8] The whole structure rested "... on the twin

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[7]Perkin quotes "... a nostalgic early nineteenth-century observer, [who was] seeking the historical 'secret of our liberty': 'In most other countries, society presents scarcely anything but a void between an ignorant labouring population, and a needy and profligate nobility; ... but with us the space between the ploughman and the peer, is crammed with circle after circle, fitted in the most admirable manner for sitting upon each other, for connecting the former with the latter, and for rendering the whole perfect in cohesion, strength and beauty'" [Perkin 22].

[8]In Samuel Johnson's words, "... the English were 'a people polished by art, and classed by subordination,' by 'the fixed, invariable external rules of distinction of rank, which create no jealousy, since they are held to be accidental'" [Perkin 25].

principles of property and patronage;" and both were exercised vigorously throughout Britain [Perkin 44ff].[9]

The importance of the landed interest was extraordinary. Adam Smith in his Wealth of Nations (1776) was a spokesman for free trade and production, but he had a deep appreciation of the importance of landed interests. While Smith supported freedom for capitalists, he also considered them selfish supporters of mercantilism, and therefore not to be trusted with political power. And in his view, the worker was incapable of comprehending the public interest. Only the landed interests "... [are] strictly and inseparably connected with the general interest of society. Whatever either promotes or obstructs the one, necessarily promotes or obstructs the other" [Perkin 28].

The point here is that the landed interests wrested power from the Crown, and this was to be a decisive step in development. They secured the very freedoms which made industrialization possible a century later. Laissez faire, the philosophic and pragmatic underpinning of the private sector, emerged from the struggle between the ruling aristocracy and its own creation, the State.[10] The case can even be made that landed interests were instrumental as well in stimulating the intellectual and scientific basis of industrialization. It was commonplace for "gentlemen" to have an interest in science and technology, and to engage in practical experiments with technology [Perkin 67-68].

These seven factors, then, account in large measure for the initiation of industrialization in Britain. In a word, in Britain by the end of the 17th century on the eve of the Industrial Revolution, the following institutional changes and

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[9] "... the English nobility and gentry, unlike their Continental counterparts, had learned the amphibious art of dominating both town and countryside by their physical presence. Through seasonal residence in the localities and frequent re-union in metropolis and country and market town they kept in their own hands and concerted their control over all the strings of dependency and influence [Perkin 42].

[10] "Out of pure self-interest [land owners] created the political conditions--personal liberty, absolute security of property, the minimum of internal intervention, and adequate protection from foreign competition--best suited for generating a spontaneous industrial revolution. More than this, they used their political power to provide the 'preconditions', in agriculture, mining and transport, for the take-off" [Perkin 67].

common law practices had emerged in British society [North and Thomas 16, quoting and paraphrasing][11]:

-- Each factor of production received the bulk of its economic value;

-- Land was in the process of passing into private hands, with the owner having the right to exclude others from its use and freely to sell or lease his property. Any improvements made remained the property of the owners, who therefore were motivated to use their property to obtain the highest returns;

-- Labor had been largely freed to seek its best employment; what skills a workman developed were his to sell as best he could, and he was no longer subject to arbitrary exploitation by some third person;

-- The development of private property and the legal enforcement of contracts raised the rate of return on undertaking all kinds of economic activities (by reducing the costs of externalities and risks that had been present in the feudal world); and

-- The development of a patent system and other laws protecting intellectual property encouraged the growth of innovation.

All of these economic, social, political, and cultural changes occurred prior to the end of the 17th century, and their cumulative effect was vastly increased productivity. In contrast, the society which they replaced had been concerned

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[11]This general view of the matter can be contrasted with the Marxian perception of Western development [North and Miller 17]: "There are striking similarities--and differences--between this model and a Marxian model. In both, the development of a system of private-property rights was a critical aspects in unleashing the productive forces of economic growth (capitalism in the Marxian terminology). There are other similarities in the analysis of the characteristics of the feudal economy and the capturing of rents (surplus value) from the labour of the serf. Both this model and Marxian writing on the seventeenth century look upon it as a century of turmoil in which a basic restructuring of political power was necessary to complement the institutional changes essential to economic growth (a capitalist system). The most critical difference is in the sources of disequilibrium in the system which induced change. In the Marxian model it is technological change. In our model it is the change in relative prices and expansion in the size of the market."

largely with the control of wealth rather than with its increase.

These were the more important preconditions of the Industrial Revolution in Britain, and they were all in place prior to that Revolution. Is this story too simple? Yes. Are important ingredients left out? Yes. Are there competing explanations? Yes, in part or in whole (e.g., Marx). Despite these short-comings, is there a lesson here? Yes. The single, over-arching "truth" evident in this story is that the market-based Industrial Revolution was a Western phenomenon, rooted in centuries of Western culture, and peculiar to Western Europe.

The story since the Industrial Revolution is perhaps more familiar to most of us.[18] Britain and Western Europe became world forces, and they sustained colonialism well into the 20th century. The transplantation of the British model to the U.S. resulted in even more spectacular growth and development. Countries outside of Western Europe and its immediate descendants languished economically, socially and politically, the first major break occurring with the Russian Revolution and state ownership of the means of production and central planning. It is important to note in this context that there is no evidence that colonial areas would have carried out a significant technological transformation in the absence of colonialism.

This spectacular Western experience exacted the most extreme human costs. In Britain, such varied writers as Charles Dickens and Karl Marx catalogued the appalling misery accompanying development. In the United States slavery was not legally prohibited until 1863, and its institutional carry-over even today requires active enforcement of legislation barring racial discrimination. Child labor was common, and it was not until the 1920s that statutes were established stipulating maximum hours and minimum wages for children and women. Women's right to vote was not secure until a Constitutional amendment in

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[18]We have not utilized the concept which Walter Rostow called the "stages of growth." Although it is a fair description of some important events in British history, and although such terms as "take-off" and "self-sustained growth" are now part of the lexicon of development, Rostow's stages approach has been criticized on empirical as well as theoretical grounds, and is not taken seriously today by scholars as an explanation of Western development. See Henry Rosovsky, "The Take-off into Sustained Controversy," Journal of Economic History, March 1965, pp. 271-275, and W. W. Rostow, ed., The Economics of Take-Off into Sustained Growth, (New York: 1963). This is taken from the proceedings of a Conference sponsored by the International Economic Association.

1921. Labor was routinely and savagely suppressed in both Britain and the United States until World War II. In the latter, it was not until legislation of the 1930s that labor even gained the "right" to bargain collectively. In Britain, the legacy of labor suppression has been class bitterness, and a labor-union movement with a left-wing cast. The business cycle, with a boom and then collapse, came to be the hallmark of Western development, reducing the welfare of millions with each occurrence. The human cost of colonialism is still evident today as less-developed areas try to fashion nations out of the "hodge-podge" of borders created by Western nations, and to overcome the social, economic, political, and cultural destruction left in the wake of colonialism.

Western market-led development sends a very mixed message to countries who would develop today. On the one hand, success rested on a set of preconditions unique to Western Europe. Moreover, it was accompanied by extraordinary human costs which no society would "choose" to incur. No wonder, then, that there is continuing argument over the relevance of the Western model to LDCs.

Today, with emphasis on structural adjustment and policy reform, it appears that this argument is muted. It is very clear that a government with a huge deficit, balance of payments problems, a ruined agricultural sector, and a rapid rate of population increase, is in trouble, and that significant change is required, perhaps beginning with prices. As has been said, getting prices right is not the end of development, but getting prices wrong frequently is. Knowledge of Western development suggests, however, that getting prices right is both too simple and is, at any rate, merely the beginning.

Market-led development on the basis of private property (i.e., in non-socialist nations) requires supporting social, political, cultural, and economic characteristics which require time to evolve. Lacking such institutional underpinning, market-led development must rely on substitutes for those characteristics, or on institutions which overcome their absence. For example, a partial substitute for a developed legal system might be local "community courts" entirely supported by small business and outside the formal system of government. A common example of an institution substituting for the absence of legal markets is, of course, smuggling and the "second economy," as it has come to be called in many parts of the world.

A case has been made that much of Latin America "...lacks the legal institutions required for broad based, economic development to take place and for participatory democracy to

function" [de Soto] 2].[13] Entrepreneurship is discouraged not because of innate features of the "Latin culture" but by laws.[14] What is lacking are the "... facilitative aspects of the law--property rights, contracts and torts--which are indispensible for growth." This is coupled with extraordinary legal constraints on business activity ("red tape," outright prohibition of private activity in some sectors, constraints on business activity of the poor). As economies under these conditions fail to respond to changing world conditions and to the growing material needs of the population, the informal (often illegal) sector expands, first rivaling then dwarfing the legal sector, as in Peru.[15]

In effect, "market-led development" is merely a slogan unless accompanied by appropriate institutional changes. Further, if the human costs of the Western model are to be mitigated (dare one say avoided?), a strong and positive state role is implied. Markets do not automatically provide for increased welfare for all--they do very little, for example, for unskilled, illiterate persons. And markets themselves require a legal and institutional infrastructure for their support. This

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[13]Our remarks here are based on this interpretation of recent Peruvian history. The article summarizes some of the work of the Instituto Libertad and Democracia, and its author has written a book along these lines (The Other Path) which is attracting wide attention internationally.

[14]It is now generally recognized that there is no "shortage" of entrepreneurial talent, that entrepreneurship is not a serious constraint on development anywhere in the world. The problem more frequently is a legal setting which worsens the uncertainty and risk-bearing nature of entrepreneurship, and which therefore tend to reduce innovation and investment. For a summary of scholarship on this issue see Leff.

[15]In his introduction to de Soto's book, Mario V. Llosa suggests [Llosa] that "one of the most widely accepted myths about Latin America is that our backwardness results from the principle of economic laissez-faire adopted in almost all our constitutions when we achieved independence from Spain and Portugal.... According to this myth, the opening of our economies to market forces made us easy prey to imperialists, whose voracious business practices brought about the inequities between rich and poor." In contrast to this view, Llosa suggests "...that Peru--as well as other Latin American countries and probably the majority of third-world nations--never had a market economy. ... It is only now, with the proliferation of black markets, that Peru is beginning to get a market economy: a savage market economy, but a market economy nonetheless."

means that market-led development must become a matter of private initiative supported, stimulated and in some cases guided by public initiatives if it is to be both productive and humane.

This statement does not raise any new issues of theory--even Adam Smith perceived of the need for an active state to suppress the tendency of the private commercial interests toward mercantilism. Empirically the matter is equally self-evident. Among the Gang Four (South Korea, Taiwan, Singapore, Hong Kong), South Korea and Taiwan are pre-eminent, and in each the private sector has been led by the state to act in ways conducive to realization of the state's development strategies. Today the question is largely a matter of the optimal balance between private and state initiatives which will vary, of course, country by country.

Preconditions of Development in LDCs

We have outlined above some of the salient institutional changed which preceded and which made possible the Industrial Revolution in Britain. Now we ask whether these preconditions are absent or present in less-developed countries as they seek development based on a market-led, private enterprise economy. Features highlighted are those which were important in the market-oriented economies of Great Britain and, by implication, of the United States.

1. Low absolute and relative economic levels. LDCs began their development struggle 30-40 years ago at per capita levels of production which were far below the levels at which Western development began. Moreover, at the time of the Industrial Revolution Europe was enjoying levels of income which were superior to those anywhere else in the world. Low income levels have a variety of results, the most obvious among them is the difficulty of generating sufficient levels of savings. And the fact that LDCs individually are relatively minor actors in the world economy often prevents them from conceiving a strategy of development which they themselves control. Britain, in contrast, was "top dog" for a century.

2. Absence of institutions critical to the market model. The institutions of property, security of that property, and contracts governing its use, were all essentially in place prior to the Industrial Revolution. In LDCs today such institutions are advanced in some countries and absent or distorted in others. The landed aristocracy in England forced on the Crown

those characteristics of British society--personal liberties, absolute security of property, a minimum of government interference--which came to underpin industrialization. In LDCs today the absence of these characteristics, crucial to market-led, private enterprise, is sometimes the general rule.

3. Weak peasantry. In Western Europe the personal status of the peasantry had been enhanced through periodic labor shortages, a long period of slow inflation in the 16th century which reduced the real cost of holding long-term leases, and the spread of manufacturing to the countryside. In LDCs, in contrast, the peasantry has been harmed economically, socially, politically, and culturally, first through colonial policies, and then in the post-colonial period for several decades by government policies which put industrialization and the import-substitution "package" first, turning internal terms of trade against the peasantry. The weakened peasantry, and the high rates of population increase, have resulted in widespread and self-reinforcing impoverishment of rural life.

4. Limited influence of science. Prior to the Industrial Revolution the waning of Church power, a growing sense of materialism, and the Scientific Revolution were associated with both rising nationalism and a sense of mastery over nature. In LDCs today these characteristics are clearly visible, but in some regions the culture they represent is a small fraction of society. Traditional wisdom and authority are still profoundly important. Science writ large is still not a basic part of the culture.

5. Weak levels of sovereignty. Science and related activities (schooling, information flows) flourished in part because they grew in nation-states with high degrees of sovereignty. Science was linked to the competition among them for power and wealth. As Simon Kuznets suggests [Kuznets 14-15], "it is hardly an accident that the three slogans of the French Revolution--the political corollary of the Industrial Revolution and an important element in the modern economic epoch--have nationalist connotations: liberty--internally from traditional oppressions that run counter to equality, externally from tyranny from abroad; equality--for members of a nation-state; fraternity--for these same members of a community to which their allegiance must be strong." In LDCs today statecraft is an underdeveloped art, many states lack essential characteristics of sovereignty, and in many such states the powers of government are used capriciously in favor of this or that interest depending on local and international political winds.

6. Weak links between the military and nation building. The early developed countries of Europe, and most successfully England, used violence to subdue vast areas of the world,

thereby creating sources of raw materials and markets. LDCs today spend a significant portion of their national budgets for "security" measures which are largely of internal importance--aggrandizement of a major political force, the military establishment itself, and the subjugation of their own peoples. While the military reinforced the "nationhood" of early developers, today it frequently is little more than the instrument of local power groups whose actions bear only random relationship to the needs of nation building.

Programming Implications for A.I.D.

We have shown that many of the important ingredients of the early development of Western Europe are today absent in many LDCs. While this is important it may not be as serious as might first appear. Several countries have, after all, achieved spectacular development in historically unprecedented short periods (e.g., the Gang of Four). Other countries clearly have begun to industrialize (Mexico, Brazil). At the same time, dozens of countries have taken only the first rudimentary steps toward industrialization or development (the two are not synonymous, of course). In what follows, we lay out some of the more important implications for A.I.D. which appear to flow from the absence of the preconditions which were important in market-led development in Britain.

At base, these ingredients can be divided into two groups: economic and institutional. Among economists, the importance of the former is obvious. Yet, our stress here is on the institutional, for reasons which are stated succinctly in a leading textbook on development [Gillis et al. 14]:

> Economic theory tends to take the <u>institutional context</u> (the existence of markets, of a banking system, of international trade, etc.) as given. But development is concerned with how one creates institutions that facilitate development in the first place. How, for example, does a nation acquire a government interested in and capable of promoting economic growth? Can efficiently functioning markets be created in countries that currently lack them, or should the state take over the functions normally left to the market elsewhere? Is a fully developed financial system a precondition for growth, or can a nation do without at least some parts of such a system? Is land reform necessary for development, and, if so, what kind of land reform? These institutional issues and many others like them are at the heart of the development process....

What is suggested here is a view of strategic planning within A.I.D. which recognizes the importance of classical economic problems but which gives equal weight to the social and political system of the LDC. This may be called a political economy approach to development.

1. The long view must govern programming. A.I.D. resources are relatively minor compared to development needs in LDCs. Therefore, these resources must be used in ways with the greatest economic impact. While short-term needs clamor for attention (unemployment and underemployment, hunger, housing, medicine), the longer-term needs of institutional change will eventually decide whether development is to occur. South Korea is a case of legitimate economic development because the social and political underpinnings of development appropriate to that culture were in place at the beginning of the process. Growth without development is characteristic of LDCs where these preconditions are absent: much of Central America, for example, or Ghana under Nkhruma, or the Philippines under Marcos. The central challenge is two-fold. First, research and experience must guide A.I.D. funding for those aspects of development central to the institutional underpinning of market-led, private enterprise development. Second, the U.S. needs to develop the social and political maturity to recognize that foreign economic assistance must adopt planning horizons of decades, not one or even a few years.

2. Absolute poverty requires priority attention. Because LDCs are attempting development from such relatively low levels of per capita income, the frequently observed worsening of income distribution becomes intolerable. Income distribution is not a matter of the laws of nature, let alone the laws of economics. Income distribution rests on the strategy of development chosen. Since the major asset of the poor is their labor power, labor-intensive development must be part of any strategy. And since most poor are in rural areas, agricultural development and asset redistribution become important. For example, land redistribution in Taiwan was critical to a more equitable and politically acceptable income distribution there, as was widespread primary education. Surely one of the great mysteries of development is why donors have not insisted that LDCs not only get their prices right but provide the opportunity for universal literacy since education is clearly a basic ingredient of modern growth.

3. Costs of institutional innovation need to be reduced. Every country is not doomed to have to go through three centuries of merchant capitalism before it can begin serious growth. It surely cannot be true that LDCs must wait on creation of a specific set of preconditions before development can begin. This position is unwarranted theoretically, it is untenable politically, and empirically it is unfounded. It is

nevertheless true that development will require significant institutional innovation. As Kuznets notes [Kuznets 6], "even if the impulse to growth is provided by a major technological innovation, the societies that adopt it must modify their preexisting institutional structure. This means substantial changes in the organization of society--an emergence of new institutions and a diminishing importance of the old." In effect, institutional change is the political and social corollary of structural change in the economy. Institutions change when those leading the society consider that the change is worthwhile.[16] Therefore, while the U.S. cannot determine when and what changes are to be made, it can identify forces causing or requiring institutional change and through economic assistance reduce the costs of the trade-offs involved in such change.

4. Substitutes need to be created for missing preconditions of development. Each LDC is one of a kind, and there is no simple list of barriers to development which each nation must overcome. But when barriers are discerned, LDCs can be helped to "invent" ways to cope with the absence of the economic, social and political conditions which underlie market-based development. The purpose may be to create the necessary conditions or to develop substitutes for such conditions. Foreign experts are substitutes for absent local experts or technicians. In finance, village cooperative savings and lending institutions can substitute for a developed banking system, and the experimental "Venture Capital Company" being

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[16]In principle, institutions change or are created when three conditions are present: when the advantages of the change are known to the change agent; when the net value of the change exceeds the cost; and when the change agent is assured of retaining the benefits of the change. Conversely, and put simply, institutions may remain unchanged over long periods when it is thought that the cost of change exceeds the benefits. Beyond the level of principles, there are the questions of the central conceptual components of policy decision-making, determination of the institutions which control policy or influence policy change, and the possibility of managing change in ways which are less institutionally intensive or demanding. See Geoffrey Lamb, "Managing Economic Policy Change," Washington: World Bank, 1987), Discussion Paper 14. While concerned mainly with policy changes, this paper has implications also for management institutions. See also Arturo Israel, Institutional Development: Incentives to Performance (Baltimore: Johns Hopkins University Press, 1987), for general lessons learned in World Bank experience with institutional development.

studied in Appropriate Technology International might bring appropriate technology to rural areas[17]. A "wildcat" banking system (e.g., the rather reckless banks which moved capital to the American West in three decades prior to the Civil War) can substitute for a more stable but also more constrained banking system. Legal impediments to markets can be abolished and simple "rules of conduct" can be established as a first step toward creation of a full legal system. Such new institutional creations stand the best chance of success when they meet an economic need and are congruent with the local culture.

5. LDCs need to be helped to achieve political stability. The association between political stability and development is firmly established theoretically and empirically. What is quite unclear, however is the precise relationship between kinds of political systems and kinds of economic systems. There is no theory of the state which will tell us that under an x-type of political system, y-type of economic institutions are supportable. The salient fact here is that LDCs today are operating under political systems profoundly different from those in Britain on the eve of industrialization. Kuznets suggests that there are three minimum political requirements for development today [Kuznets 451-453]. First, some degree of political stability is required so that planning can occur, and so that there will be some stable relationship between effort and reward. Second, since conflicts will inevitably occur, a government must be able to recognize these conflicts in advance and minimize their destructive effects. Third, a sufficient degree of "representativeness" for the different groups in society is required so that group interests can be routinely expressed when government decisions are taken. While the "weighting" which one might give to these three requirements will differ among LDCs, they all are important if market-led development is to occur.

6. A strong role for government needs to be supported. The economies growing most rapidly and at the same time improving the lot of the poorest are those economies in which a strong, active and "successful" government plays a positive role as a partner with the private sector. A.I.D. programming can build on this experience and translate it through research and experiment into knowledge which can be used in other countries. As Gillis et al. note [Gillis et al. 31], because the Chinese had the experience of Soviet planning before them, they could move rather quickly to set up a centrally planned economy. Similarly, "... South Korea learned much from the experience of Japan about how to operate a privately owned but state-managed economy." LDC interest in both the Soviet and Chinese models has waned. Today LDCs increasingly look to the East Asian

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[17]See the evaluation report by Bundick and O'Donnell.

models to understand the leading role that government can play in development.

7. Ways need to be found to stimulate the culture of science. The hallmark of the modern era is the application of science to problems of production. Any nation which would develop will come to rely on science at its most advanced. Hybridization, which must increasingly be used in agriculture, is an example. The use of satellite weather stations is another, and both will be critical not only to those LDCs with advanced agricultural sectors but to those with primitive sectors as well. Energy problems will persist in LDCs, and their long-term solution will rest on science whether in the provision of solar power, efficient wood-burning units, or atomic plants. A central question for A.I.D. is how LDCs can be helped to utilize the most advanced science available. Of course, the most sophisticated and advanced technology is not always the most appropriate. What is needed is technology appropriate to local conditions. In some cases this might mean emphasis on building a first-class research university to educate intellectual elites for an entire region of the world. Or, it might involve a stress on rural and urban extension agents carrying the message of advanced technology. It might also mean the creation of small centers throughout a country which specialize in creating very simple machines and tools to accomplish basic agricultural tasks. It surely will mean wider primary education if the culture of science is to permeate a society.

8. Special attention is required for international economic relations. The general theories of "imperialism," and their cousin "dependency" in its various forms, are discredited fairly easily if universality is claimed. Nevertheless, there is a widespread belief among LDCs that close economic ties with world markets (largely capitalist markets) reduce the maneuverability of governments, and make domestic policy hostage to forces over which LDCs have no control. In almost all cases there is some degree of truth in this proposition. At the same time, however, all of the alternatives to participation in the world economy are fairly unattractive. Therefore, in A.I.D. programming it is important that LDCs' fear of outside control be given special attention, for three reasons. It will ensure that the real danger perceived by LDCs is examined "up front" in A.I.D. planning. Second, it will reassure LDC governments that the program or project on balance at least will not undermine its autonomy. Finally, by placing this issue in the forefront, the credibility of A.I.D. assistance will be strengthened. For well known reasons, part of U.S. assistance sometimes appears to have been designed for U.S. domestic purposes rather than for LDC development. In the eyes of developing countries, this weakens both the thrust of our analytical work and suggests that the word "aid" is something of a misnomer.

9. Social and cultural integration must be assisted as key to nation building and economic development. To one degree or another, every LDC has been affected by the Western culture in many well-recognized ways: multinational corporations, radio, television and movies, education and training of elites, and so on. In a sense, it is "too late" for LDCs to develop their own model--one neither market-oriented nor centrally controlled. The Westernizing modernization model with its emphasis on markets has already taken root, and is reinforced daily. Economic assistance must recognize that a prime requirement now in LDCs is the forging of a new culture, with the attendant social costs involved in replacement of old values by new. For example, in the West, museums have been used for centuries to celebrate culture and nationhood, and to reinforce a people's sense of accomplishment and pride. In many LDCs the typical museum may be something of a white elephant, but there are other ways culture and accomplishment can be celebrated, as anthropologists can explain. Government stability, participation, and cultural diversity shaped to common values, are all key ingredients of development. Economic assistance to help a country develop a modern orientation and greater societal integration can be potentially as important to development as, say, a new docking facility or any other type of infrastructure. It is this cultural infrastructure which requires greater emphasis in A.I.D. funding.

Summing Up

While funding has always been limited, A.I.D. has played an extraordinarily important role in world development in ways that need not be summed up for those in the Agency. At the same time, that role has often puzzled the rest of the world. For one thing, formal policy statements appear to suggest that A.I.D. changes its fundamental direction about every 10 years. In the late 1970s, for example, "new directions" and a "direct attack on poverty" were the battle cries, while today in the late 1980s emphasis is on structural adjustment, conditionality, and policy reform.

This impression of policy shifts, however, is rather misleading. A.I.D. practitioners who have lived through several such formal shifts point out that things in the field do not really change that much: poor people are always a concern, improving local agriculture is always a concern, getting markets to work is always a concern, helping governments to improve their efficiency and serve broad interests is always a concern, infrastructure is always a concern. These are abiding issues which will linger as priorities in A.I.D. programming because

they are issues crucial to development, and A.I.D. practitioners know this year in and year out.

At the same time, A.I.D. programming reflects political interests of the United States. How, given this "fact of life," can A.I.D. programming nevertheless reflect the development needs of LDCs? We have suggested above that a partial answer must lie in the recognition of the equality between the goals of growth and structural change on the one hand, and the necessity of social, cultural, and political change on the other. The two sides of development, then, are economic growth and institutional change, and A.I.D.'s role must touch both.

The story of British development, and by implication market-led, private enterprise development, seems rather simple in retrospect, and spectacularly successful.[18] There is one thing that the story does not tell us. It does not say that industrialization will fail unless carried out under these conditions. First, there is no theoretical basis for such a statement given the wide array of choices among economic systems. Second, empirically there is the "command economy" model of the U.S.S.R. in which industrialization occurred with the suppression of market forces. (That such forces are apparently to be given greater power today in the U.S.S.R. does not vitiate this statement.)

In a word, history suggests that there is no single development template that can be used the world around. Each country has a different potential for adapting and using the world's technology and knowledge. The purpose of outside funding from donors, then, is to help each nation find that pattern of change which best suits its potential. For example, in some cases, the extended family may inhibit economic growth and in others it may not. In some cases privatization of land makes economic sense and in other cases it may destroy the "self-insurance" inherent in communal use of land. The implication of this for A.I.D. is that greater weight be given to empirical studies of what works in development under what

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[18]In effect, economic growth depended on the creation of institutions and property rights which tended to bring the private rate of return closer to the social rate. Changes in relative factor and product prices, partly related to population change, and changes in market size, caused fundamental institutional changes which in turn caused economic activity to gravitate toward productivity-increasing economic activities. Precipitating factors in all this were the potential to be gained from economies of scale, and the reduction of costs of externalities, information, and risk.

conditions, and that A.I.D. move more closely to an agenda driven by empirical studies. This may reduce the necessity of publishing over-arching A.I.D. "policy statements" periodically, and may release us to do what our knowledge tells us is necessary rather than what our belief suggests is appropriate.

At the risk of being unfair to scholars, it may be that by the time a "truth" finds its way into a textbook it is already in the process of being replaced by yet a newer finding. If the leading development textbook today, written by credentialed people from Harvard, now can state that "... South Korea learned much from the experience of Japan about how to operate a privately owned but state-managed economy" [cited above], this is something the rest of us must take seriously. The mythology of South Korea as a "free marketeer" has, quite properly, vanished.[19] The dominant role of state management had been recognized. This suggests that we drop the ideologically charged question of the role of the "minimalist state," and proceed empirically to examination of specific instances when markets have worked well and when governments have worked well. The purpose will be to identify conditions under which both markets and government lead to increased efficiency and broader income distribution.

Increasingly, LDCs look at the NICs (newly industrializing countries) as models worth investigating. If the work of A.I.D. is to be empirically-driven, as suggested above, then more systematic and cross-country studies of the conditions under which state management of a private economy can be productive deserve priority study. In this light, the question is not whether LDCs should try to improve their markets. Obviously, the answer is yes, but it will be qualified by recognition that in many cases (e.g., Korea) prices were not "clearing prices" but were in fact rigged to suit long-run, state-defined developmental needs. A maze of subsidies helped the Korean government direct resources into priority areas. Why didn't such rigged prices and complex subsidies ruin South Korea? We

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[19]A student of the East Asian models has observed [Bradford 122]: "In the end, effective development relies on both market forces and public policies, and even on government intervention; it rests on <u>both</u> import substitution and export promotion. Credit and interest-rate subsidies, tax preferences, differential exchange rates, preferential treatment of capital goods imports, and other deviations from unfettered market signals have been integral parts of development policy. As Albert Fishlow has pointed out, 'the more fundamental proposition is that the correctness of the prices must be decided by reference to a comprehensive strategy, not independently of it'"

think we may know some of the answers. How do these answers relate to economies, say, in Sub-Saharan Africa?

The point is that the intellectual agenda on development is wide open. This is the philosophic premise which should guide A.I.D. research and ultimately programming. In some cases, our efforts might be directed toward relatively "pure" market models, while in others our priority might need to be assigned to developing state capacity for management. In most countries, it will probably be a combination of the two.

The ultimate test of a foreign economic assistance program, of course, is moral--is the program consistent with our espoused values? While it is more appropriate for others to make the judgment, A.I.D. practitioners need no reminding that the sacrifice of present generations for a greater good in the future raises the most serious moral questions. History seems to suggest fairly clear moral lessons. Slavery is never morally acceptable. Genocide is never morally acceptable. The impoverishment of millions for the benefit of the few is never morally acceptable. History has ultimately repudiated governments and peoples who practiced slavery, genocide, and institutionalized poverty. Since A.I.D. wants to be "on the side of history," economic assistance generally must go to leaderships and peoples who reject these practices.

As countries were achieving independence in the late 1950s in Africa, there was widespread optimism that as soon as the colonialists departed life would be grand. A Nigerian at the time explained the basis of this view to the novelist Charles McCarry:

> My countrymen believe that inside the British Club, where we have never been permitted to enter, there is a hidden room, and inside that room is a vault, and inside that vault is a book containing the secret of life."

There was no such room, of course, no hidden truth which would transform Nigeria. Nor is there one today. No donor agency possesses a formula containing the secret of life. Development based on formulas in the end becomes tragic because human reality cannot be conformed to formulas without repression. This is the lesson history suggests.

The role for A.I.D. thus becomes one of helping LDCs understand their own capabilities in light of their own values and endowments. The focus of analysis is perhaps best shifted away from "patented" strategies to the issue of balancing the need for immediate growth with the concurrent need of establishing the institutional framework to make such growth self-sustaining. It is apparently true that because of the force of "international communication" LDCs increasingly will

opt for a modernizing, market-led model of development. Under these circumstances, A.I.D. can do two things. It can help LDCs overcome the time gap required for creation of institutions supporting market-led development, including the creation of strong competent government. Second, it can help prevent the poorest from bearing the full weight of the structural shifts which will accompany development under market-led growth.

While this is a relatively prosaic mission, it does have two advantages. It removes the presumption that somebody knows exactly where LDCs are going or should be going. We are still trying to glean the beginnings of knowledge on what the phrase "information revolution" may mean for us; what it means for LDCs is even more mysterious. There is still speculation on what it means for development to be a "late comer" to industrialization. There are no known minimum levels of saving, education, health or any other ingredients of growth which have been empirically established or theoretically suggested. Despite all of our accumulated knowledge about patterns of development, there is no single theory of development to guide us. In this context, prudence suggests that any donor should approach an LDC with both caution and humility.

A second advantage of this modest approach is that it puts the emphasis on development with the LDCs themselves. No outside force or knowledge is going to "save" LDCs. In a sense, any LDC which requires outside pressure to do what it must do for itself is not prepared for development. This is the ultimate criticism of conditionality. In effect, it gives the LDCs one more reason for failure which can be explained as resulting from outside pressure. Donors of course have the power to apply conditionality, and in some cases it does seem eminently appropriate. But it represents at base the application of an approach which in many respects is culture specific. Markets will work in LDCs when the preconditions or suitable substitutes are in place. There is little evidence in history that changes in economic, social, political, and cultural life can be implanted from one culture to another in a few years. The LDCs themselves must work to develop these conditions, and the role of the donor, in this light, is to help them work on this long-term issue.

All of this can be summed up this way. Thirty years ago LDCs widely adopted state planning and management while they still lacked the rudiments of efficient public administration. The economic results were in most cases disastrous. That choice rested on a combination of nationalism and a desperate desire for the fruits of economic growth (which was thought to mean industrialization). Today, old style state planning and management have been discredited. Yet it would be just as wrong today to urge market models on LDCs as it was to encourage them in state planning. In a sense, both models flow from economic,

social, political, cultural, and ideological moorings in the West. As noted above, the most successful LDCs of today--the NICs of East Asia--have evolved a combination of the two. Perhaps that approach will be appropriate in many LDCs. We just do not know what will work under what circumstances. What we do know is that LDCs, for better or for worse, will have to find their own ways. And in doing so, it is as clear today as it was 30 years ago that LDCs are apprehensive over the embrace of either Moscow or Washington [Kennedy 393ff.].[20]

This is a world, then, which is growing more complex yearly, and where there is suspicion that the great powers have their own interests which may conflict with those of the LDCs. In this emerging world the role for outside donors is to help the LDCs find their own ways toward development.

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[20]See also his letter to The New York Times, July 3, 1988.

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