STUDIES IN POLITICAL ECONOMY OF DEVELOPMENT

IGNACY SACHS

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by

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Introduction

The crisis of development is also a crisis of development theory. Economic growth alone, however rapid, cannot solve social problems and banish misery and unemployment. To start a long-term development process requires more than a partial modernization of the production apparatus and the mirage of unbridled urbanization which often result in the lowering of the quality of life of most town dwellers.

The imitative model which favoured the course followed earlier by industrialized countries is worn out. Cultural dependence and intellectual self-colonization which constitute the extreme form of this model do not prevent imitative growth from proceeding at a more rapid rate than that registered in the past in capitalist countries. But importing into poor countries a model of accumulation and of society founded on inequality only emphasizes the inegalitarian nature of growth. As long as the élites of these countries can afford to consume as much or more than their counterparts in rich countries the vast majority of the fringe population will be forced to live on a derisory income.

Growth through inequality results in the waste of scarce resources allocated for superfluous production, and also in underutilization of land belonging to owners of large estates and overexploitation of land belonging to small farmers. It is therefore doubly destructive from the ecological point of view.

Instead of the present imitative growth which is inegalitarian and destructive we advocate *endogenous development* geared to the satisfaction of the essential needs of the entire population and the protection of natural resources and of the environment. But we should rather speak of *developments* as the diversity of ecological, historical, cultural, and sociopolitical contexts must be reflected in plurality of strategies.

The *economics* of growth are on trial. The time has come once more for the *political economy* of development, for abandoning the elegance of mechanistic models and the simplifications of *homo economicus* for the sake of understanding the decision processes and evaluating the relative strength of economic and social factors, their behaviour, and strategies. The task is relatively easy as long as we are dealing with hypothetical models of a competitive free market or with collectivist economy of the socialist type. It becomes much more difficult in the case of mixed economies in developing countries in which both models are present, economies marked moreover by the coexistence and interpenetration of asynchronisms, or, to put it more simply for purposes of analysis, by the coexistence of traditional and modern sectors.

The time has also come for committed planning which does not hide behind the screen of technicality and political neutrality. While helping the decision-makers to think in alternatives, it does prepare the ground for their options which commit the future of society, without however claiming that it can achieve optimum conditions. Development is multidimensional; the various aims and criteria of evaluation chosen by a society have no common denominator; planning is not a province of economy but it does have an economic dimension. That is why political economy can be of service to the planner, provided it throws off the yoke of *economics* and embraces in its field of vision *all* the levers (and not investment alone) as well as the whole social and ecological dimension of growth; thus, while placing the adjective "economic" before the noun it leads to *economic policy* and over and above that, to *structural reform.*

The texts collected in this volume were written over a period of a dozen years in Warsaw and later in Paris. They were mostly commissioned by the United Nations, their specialized agencies, and other international organizations. Originally written in English (but difficult to obtain), they were for the first time published as a single volume in a French translation in 1977. They are meant as a contribution to the recently opened field of the political economy of development and of the theory of planning in a mixed economy. We have preferred to keep to the original versions so as to maintain the autonomy of each text. In some cases this makes for repetition and some of the figures are out of date, but in any event they are only intended to indicate relative values. It seems useful to us to show how the same concepts—e.g. that of "perverse growth"—work in various contexts and circumstances. Moreover, we wished to preserve the form imposed by the very nature of these studies primarily designed to provide a basis for friendly dialogue with planners and policy-makers of developing countries.

This volume is dedicated to the memory of the late Michal Kalecki to whom I owe a great intellectual debt. My thanks go to the international organizations for their permission to reproduce these texts and for their assistance in preparing them.

Ignacy Sachs

Contents

CHAPTER 1

Some Considerations of Long-term Planning in Mixed Economies (1968)

This chapter draws inspiration from ideas and methods elaborated by Professor Michal Kalecki and discussed by him in the following four essays, published in successive volumes of *Essays on Planning and Economic Development* of the Warsaw Centre of Research on Underdeveloped Economies:

"An outline of a method of constructing a perspective plan"[1]
"Problems of financing economic development in a mixed economy"[2]
"Main differences between developed and underdeveloped capitalist economies"[3]
"Determination of the rate of growth of the socialist economy under conditions of unlimited surplus of labour"[4]

By *mixed underdeveloped economies* is meant economies having a significant, though not necessarily large, but in any case dynamic, public sector and a large private sector where elements of traditional and modern economies coexist both in rural and urban areas. Hence there is a possible subdivision of the private sector into the modern and the traditional (often treated as a household subsector). Wherever necessary a further subdivision may be introduced between domestic and foreign-owned subsectors of the private sector, but we should always

[1] *Essays on Planning and Economic Development*, vol. I, Warsaw, 1963, pp. 19–22.
[2] *Essays on Planning and Economic Development*, vol. II, Warsaw, 1965, pp. 37–50.
[3] *Essays on Planning and Economic Development*, vol. III, Warsaw, 1968.
[4] *Ibid.*
These papers were reprinted in *Essays on Developing Economies*, The Harvester Press, England, and Humanities Press, Inc., U.S.A., 1976; the second paper is also in *Selected Essays on the Economic Growth in the Socialist and the Mixed Economy*, Cambridge University Press, 1972.

bear in mind that an economic system cannot be treated as an arithmetic sum of its parts (thus, for instance, the coexistence of traditional and modern sectors modifies the working of the latter).

Such mixed underdeveloped economies show at the same time various similarities and marked differences both with respect to socialist and developed capitalist economies. In particular:

(a) They are, like the socialist economies, supply-determined in the main, i.e. their rate of growth is limited by lack of productive capacities, with the difference that owing to institutional reasons they usually show less capacity to overcome the bottlenecks, due to a greater inelasticity of supply of food and a lesser efficiency of controls on investment and foreign trade.

(b) Though supply-determined, in the main they share with the developed capitalist economies the problem of insufficient effective demand for some categories of goods. Thus, side by side with difficulties arising from the fact that the supply of "essentials" grown by agriculture (i.e. staple food) lags behind the demand, so that the economy is beset by inflation and capital goods are in short supply (mostly when limited capacity to import them is misallocated to projects with high prospective rates of individual return and low social priority), "essentials" and "semi-essentials" of industrial origin may be operating much below their actual capacity due to a lack of demand. The same may apply to some export-oriented production (mostly to products from perennial cultures, where the ability to adjust supply to demand practically does not exist) due to inadequate foreign markets. As for industrially produced "luxuries" (mostly durables, such as motorcars, household appliances, etc.), the market composed of a small but moneyed élite is shallow but willing to pay high prices so as to attract excessive investment in such branches to the detriment of the rest of the economy. Such an expansion may generate a dangerous euphoria with respect to the state of the economy and the impact of industrialization. In the long run, however, the excessive growth of the *L* sector will adversely affect the growth potential of the economy, so that we are really in the presence of a perverse growth.[5]

[5] Because of import restrictions in many developing countries there is considerable deferred demand for *L* goods at the moment of starting home production of the same. This makes investment in *L* industries still more attractive, but after some years saturation of the market may occur.

As a result of the above-mentioned features the financing of non-inflationary, fairly rapid growth in a mixed economy poses three problems:

(a) Adequate supply of food;
(b) Proper handling of scarce foreign exchange resources;
(c) Equitable social distribution of the burden of investment.

The first two problems arise in all the economies, irrespective of their socioeconomic pattern, but they are likely to be felt much more intensely in an underdeveloped mixed economy. This is due to the combination of high-income elasticities of demand for food and a high propensity for imports, on account of the lack of domestic production of capital goods with institutional rigidities in agriculture and structural imbalances in the international division of labour.[6]

Problem (c) can in theory be handled in a socialist economy, where wages and prices are centrally controlled,[7] but a free-market capitalist economy is characterized by a clearly regressive distribution of income, so that a corrective intervention of the State is called for in order to protect the poor strata of population from excessive exploitation. In a mixed underdeveloped economy capitalists will try, as a rule, to get the best of two worlds, namely a conspicuously high standard of personal consumption and a fair amount of private investment, financed out of public savings accumulated at the expense of the working people and/or an unnecessary high inflow of external resources. Inflation helps to achieve this aim by reducing the real income of wage earners and increasing the profit margin of traders and industrialists. Thus, a socially acceptable incomes policy will require as a minimum, on the one hand, curbs to be put on the rate of growth of personal consumption (including investment in luxury housing) of the moneyed élite and, on the other, public investment to be stepped up. Of course, inflation is ruled out.

A reasonable solution of the above-mentioned problems requires

[6] A small group of oil exporters, while successful as far as international division of labour is concerned, quite frequently mishandled their foreign exchange income by placing it in Western banks and securities instead of promoting development in their own territories.

[7] In reality the crucial political decision is that of allocation of income into consumption and investment; once it has been taken the rest is a mere technicality.

effective planning and this, in turn, rests on the following three conditions:

(a) *Control of investment through licensing* with respect to major and medium-sized projects, in order to prevent investment considered undesirable either because it does not fit into the plan or because of wrong location. Lack of such controls and reliance on a market allocation of investment will, as a rule, bring about a heavy concentration of investment in the *L* industries turning out goods (mostly durables) and services (e.g. sumptuary housing) belonging to the category of "luxuries" and in regions which are already more developed than the rest of the country.

The reasons for such distortion of the investment pattern are easy to identify: on the one hand, *L* industries, enjoying a most effective protection from foreign competition due to balance-of-payments difficulties and the consequent import restrictions, and working for a market of well-to-do people ready to pay excessively high prices for prestige goods, are likely to show rates of return to capital which are higher and quicker than any other investment opportunity (short of usurious money-lending). On the other hand, new investment is more likely to be located in areas already developed, which thus provide some external economies.

Both these trends, if left uncorrected, will add to the lopsidedness of the economy. To the extent to which excessive investment in *L* industries draws on scarce resources of the country (foreign exchange, scarce materials, and skills, as well as food, which constitutes the main counterpart of wages), it prevents the simultaneous expansion of some other industries turning out capital goods, raw materials, and intermediate goods, as well as consumer goods belonging to the category of "essentials". Though in the short run the expansion of *L* industries may bring about an increase in the national income and add to employment,[8] such a pattern of growth will prove deceptive in the long run, as it will slow down the rate of development of the industries which, contrary to the *L* industries, contribute to the "growth potential" of the country.

[8] Entirely new industries always add to employment while factories which displace existing artisan-type production may, on the whole, reduce the total employment in industries and crafts.

That is why we propose to call "perverse growth" that spontaneous pattern of growth which is based on market allocation of investment. As for the regional imbalances, again, if left uncorrected, they will become ever more acute because the process of uneven development is a self-cumulative one. Richer regions (or urban areas) will grow richer, setting out migratory movements and an asymmetrical pattern of economic interregional relations, which in the limiting case may turn out to be of a colonial-like nature.

Now, "negative" measures (controls) should go hand in hand with "positive" measures consisting of a reasonable policy of fiscal, credit, and other incentives to the private sector, which engages in projects enjoying high social priority, and of the readiness of the government to carry out through public investment all the projects included in the plan which are left unattended by private capitalists, as well as those which from the very outset were meant to stay in the public sector. Public investment in public sector enterprises (as opposed to private sector financing from public sources) has some definite advantages, as the public sector may be geared to the implementation of plans while private entrepreneurs can at best only be induced to do it, and only to the extent to which the macroeconomic interest coincides with their individual profit-seeking goal.[9] That is why the policy of incentives to the private sector should be very carefully weighed, bearing in mind that, if it becomes too expensive for the State, it might be better to expand the public sector instead.

(b) *Control of foreign trade and foreign exchange operations, including capital movements.* Foreign currency is, so to speak, the joker in the planning game, as practically all the bottlenecks (with the exception perhaps of the medium-level skills) can be overcome by imports so long as there is the capacity to finance them. In a great many cases difficulties

[9] A good instance of the evasiveness of the private sector to macroeconomic considerations is that of the choice of technologies. Social cost-benefit and entrepreneurial cost-benefit criteria seldom coincide. A private capitalist may find it advantageous or expedient (because such a ready-made technique is offered to him from abroad) to introduce a highly capital-intensive technique in a country beset by employment problems. This will happen either because, enjoying a monopolistic position on the market, he is free to fix his prices in such a way as to get a fair margin of benefit whatever the costs of production and/or because the opportunity cost of capital to him is low, contrary to what it should be, because of a wrong government policy of incentives to private-domestic and foreign capital.

due to foreign trade set, in the last instance, a ceiling to the overall rate of growth of the economy. Under no circumstances should the sensitive area of contacts between the national and world economies be left to the free interplay of market forces. The attitude of those who commit themselves to planning in the internal sphere but yield to the pressures of the advocates of free trade in the realm of foreign economic relations is doubly inconsistent. To accept free trade really means opening the back door to the doctrine of a free-market economy which is incompatible with planning and discoursing on the organization of world markets, while giving up the organization of one's own country's foreign trade means putting the cart before the horse. The doctrine of free trade has always been a weapon in the hands of the stronger against the weaker partners, not to speak of the fact that advanced industrial countries who would like to compel the developing countries to abide by this doctrine are the first to abandon it for a beggar-my-neighbour policy as soon as they feel embarrassed by balance-of-payments difficulties.

A comprehensive foreign trade policy can be worked out only against the background of the plan and, at the same time, should be an integral part of such a plan. Reliance on such criteria alone, e.g. import substitution or preference of capital over maintenance imports, may lead to dangerous complications as neither import substitution of L goods nor new investment in the L industries is desirable, while maintenance imports for the existing industries turning out goods necessary to the smooth functioning of the economy should be given high priority.

To be effective such a policy must:

(i) Operate some kind of controls on imports, preferably licensing.[10]

(ii) Subject to close scrutiny and regulations the operations of foreign-owned enterprises, in order to avoid excessive outflow of profits both legal and illegal (through overpricing of imports and foreign technical services and underpricing of exports), so as to reduce the gap between real foreign currency income and apparent foreign currency income, as registered by trade statistics alone.[11]

[10] Of course, different technical solutions are possible, a multiple exchange rate system being a substitute for or a complement to selective licensing of imports.

[11] To the extent to which the situation can be made to improve in this respect, the capacity to import of the country considered will increase, other conditions (i.e. volume of trade and terms of trade in their current meaning) remaining the same.

(iii) Operate a selective system of export duties and/or (whatever the actual case) of export subsidies.

We see no harm in subsidizing some exports so long as an uncompetitive price is the only obstacle to enter the foreign market (which usually it is not). The policy-makers will only be faced with the decision of how far they are ready to go along with their subsidies or, in other words, how much net marginal domestic cost per unit of foreign currency earned they are ready to pay. This means weighing the advantage arising from the additional capacity to import with the need to spend a greater relative share of the national income as the export counterpart to finance imports. Of course, the alternative solution, namely saving foreign currency by means of additional import substitution, should also be brought into the picture. No prejudice should be attached to either of them, except that import substitution is a safer risk, other conditions being equal (i.e. the net domestic cost per unit of foreign currency earned through exports or saved through import substitution are approximately equal). Let us observe that the above argument can be easily transposed to the realm of selection of foreign-trade-oriented investment; all we need then is to compare the effectiveness of investment into projects which earn through exports or save through import substitution the same net amount of foreign currency.[12] Such comparison between industries turning out all kinds of different goods is possible, as foreign currency provides the common denominator, and from the point of view of optimization of foreign trade it is irrelevant what specific good is being sold abroad or ceases to be purchased from outside (provided it fits into the plan).

The uncertainty inherent in foreign trade operations cannot be altogether eliminated with the means mentioned above, but the national economy becomes more fit to make the best use of the opportunities offered by trade and to adapt itself to the changing conditions of the world markets. We should perhaps add here that some degree of stability can be instilled, even in foreign trade, by means of concluding bunches

[12] Of course, we must reduce investment outlays and current production costs to a simple index. This can be done by means of dividing the investment outlays by the "recoupment period" or the inverse of the national cost of capital, fixed in such a way as to ensure the full utilization of such labour for which there is an adequate food supply to guarantee the planned real wage.

of long-term export and import contracts,[13] stipulating the volume of future transactions and the prices or the modalities of price fixation which are conceived in such a way as to reduce the amplitude of their fluctuations. Governments of the parties concerned should guarantee, either directly or indirectly, the implementation of such a contract if they are to become effective instruments of action.

(c) *Indirect control of the price line* (except for fluctuations motivated by shifts in terms of trade which are *vis major*) by means of appropriate agricultural policies, meant to ensure equilibrium between supply and demand on the market for staple foods, the main counterpart to wages. For the developed countries, Professor M. Kalecki proposed an administrative control of prices and freeing of wages, so that any increase in nominal wages[14] obtained by the trade-unions would be tantamount to a genuine redistribution of income in favour of workers. But in underdeveloped countries the situation is different: so long as essentials are in short supply all attempts to keep prices stable by administrative measures will prove to be in vain and will only bring about speculation and the black market. Theoretically, one could think of rationing. Such a form of distribution requires, however, a very smooth and integer organization, and even then a reasonable supply of essentials per head of population. Thus, for practical purposes it must be ruled out in mixed economies, as there would not be much chance of enforcing a distribution system encroaching drastically upon the consumption of the upper classes (who also eat essentials) while improving the lot of poor people, not only in relative terms but also in absolute terms. The only way left is, therefore, the one suggested at the beginning of the paragraph, namely respecting the income elasticities of demand for essentials and supplying staple foods in sufficient quantities to keep the prices stable. A comprehensive agricultural policy must therefore be built into the plan, combining institutional measures dealing with land tenures and commercialization (freeing the peasant from the domination of landlords, traders, and money-lenders), technical assistance, and investment. The utmost attention should be given to the

[13] We insist on bunches of contracts, because package deals give scope for exchanging concessions and arriving at a reasonable distribution of gains between partners.

[14] He made this point at an Italian–Polish Roundtable on Planning, held in Ancona in May 1965.