Incentives to Economic Development : Effect of Governmental Policies

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Anand, 10th December, 1962.

Economic development = increasing the sum total of goods and services

Purpose?

"Life, liberty and the pursuit of happiness" acceptable to most.

Building of power and war machine another alternative.

Thus economic growth means to an end

Same basic laws; formation of capital and productive investment

Capital required for increasing production and productivity
Capital as basis ~~for~~ in investment and investment in saving.

Savings are the difference between income and expenditure,
between output and input

All systems have to accept these laws

How? Hard Work
~~Intelligence~~
Initiative
Enterprise
Risk

What works there?
Human nature being what it is.
J.P. – We are mixed.

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A. <u>Institutional Framework</u>

1. <u>Rule of Law</u>

The foundation of institutional framework - security

Equality in the eyes of law
Due process of law
Even bandits have their own code of honour

Totalitarian dictatorship aspires to "socialist~~ic~~ legality"

2. <u>Stable Currency</u>

Money - measure of value, means of exchange and link between past, present and future.

Inflation - anti-social and anti-socialistic
Kripalani - "pick-pocketing"
M.R.Masani - "counter-feiting"
Keynes, much misunderstood, observed that debauching a currency saps the foundations of a society more subtly, swiftly and permanently than any other conspiracy.

Specially important to developing country

Graham Hutton in <u>Inflation and Society</u> (1960):
"From that ~~pont~~ point or stage there are only two roads; one leading ~~to~~ to the overthrow of democracy and personal freedoms altogether; the other leading back to sound money and a reasonable balance between State and private economic action, upon which personal freedom depend....

"The fallacy that you can control inflation in a democracy through bureaucratic controls over prices, production and trade persists among us today. But only symptoms are removed; the lady has her double-chin removed by surgery, only to discover it at the back of her neck. The State - today or in history - merely removes one symptom and replaces it with another; favours a new class of person by inflation, while penalizing another; or, in attempting to regulate social and economic life while persisting with inflation, runs the machinery of democratic government, the currency itself, and the entirety of social law and order headlong into catastrophe....

"The inflating modern democratic State faces this trilemma...

It must abandon individual and social freedoms if it is both to form new capital fast enough and to inflate. It must abandon inflation if it is both to conserve freedoms and to form capital fast enough. Or it must abandon hopes of rapid material progress (new capital formation) if it is both to inflate and to conserve individual freedoms."

High cost structure - Exports

3. Security of Property

Property result of saving
Converted into productive means from which one derives continuous benefits.

e.g. Productive means = house, farm, share in corporation
Continuing benefit = rent, interest or profit, ~~subject~~ Subject to regulation by Government.

Where right to property denied, human nature being what it is, difficult to induce people to work, risk, save and invest.
Even Soviet regime now beginning to appreciate importance of property which being smuggled in under various guises
e.g. Soviet millionaires no estate duty.
Income tax less than 20%
Private plots on collective farms produce most dairy products, vegetables and fruits.

"The life of a capitalist. Have to work so hard after all."

Nationalisation the ~~economy~~ enemy of private property
Now outdated
British Labour and German Socialists have discarded it.
Quote "Who is Outdated?"
During last Elections conceded that Labour lost a great many votes because of bogey of Nationalisation
Western Socialists accept peasant proprietorship as best form of agriculture.
Collectivisation and communes failure
~~e.f. Kelf-Cohen.~~
Keynes: "It is better to let people tyrannise over their bank balance than over their fellow men."

4. Profit and Reward

Profit motive as incentive
Not all men equal
To deny differential returns tentamount to repudiating not only productivity but also social justice.

Profit yard-stick of efficiency - no economic progress without it.

Khrushchev - 22nd Congress, 1961, warned against reckless haste in leaping into communist practices in the field of distribution and wage policies. Rewards of labour should be distributed according to work done.

Yugoslavia well ahead

London <u>Times</u> - April 1961:
"Profitability, productivity and competition are no longer ideas on paper but are beginning to affect and change individuals as much as they are affecting the enterprise they work in. It is this, the recognition of economic incentive and the free formation of prices through competition and market conditions, which distinguishes Yugoslav Communism sharply from that of the Soviet bloc."

<u>In developing countries</u> need for incentives all the greater since initiative, enterprise and capital scarce.
Rapid economic growth = maximisation of output.
Khrushchev (<u>Time</u>, May 4, 1962) "If Communism is proclaimed where there is, say, one pair of pants per ten persons, and these pants are divided equally into ten parts, we shall all be going without pants. We reject such pants-less Communism".

~~Mr. & Mrs. Gagarin~~
~~Khrushchev and ball pen~~

Limited resources should be invested where they yield highest output.

Professor J.K. Galbraith, currently U.S. Ambassador in India, has also something to say on this subject in his book <u>The Affluent Society</u>, which is often overlooked by his gushing admirers:
"To give people income and then remove it by taxation, inflation or appeals to thrift is an inefficient and self-limiting procedure....In poor and ill-governed societies, private goods mean comfort and life itself. Food, clothing, and shelter, all technically subject to private purchase and sale, have an urgency greater than any public service with the possible exception of the provision of law and order.

(contd.)

The burden of proof is on any step that diverts resources from the satisfaction of these simple biological requirements to the almost invariably spendthrift services of the State."

In under-developed countries imbalance between man-land and man-capital ratio
Over-population
Canning : "Bring in ~~a~~ the new world to redress the balance of the old." i.e. Foreign capital
Importance of creating proper climate.
Where incentives to indigenous capital lacking, foreign investors unlikely to come.
HM Patel: Must qualify - By putting to best use,
Better way of getting foreign capital through equity
~~No~~ Government to Government loans - explain

Issue of whose risk ?

Professor P.T. Bauer, Professor of Economics (with special reference to Economic Development and Under-developed Countries) in the University of London, has said in his book Indian Economic Policy and Development (1961):

"A society resistant to the appeal of a totalitarian regime and experiencing economic advance in the sense of enjoying a general rise in living standards. Such a society would generally be one with the following characteristics : the economy is developing; people have wide access to alternatives both as consumers and as producers; decision-making is decentralised and widely dispersed; the power of individuals over others is limited; people do not experience violent and discontinuous disintegration of their communities; large numbers of people own some property. And economic advance, if it is to be meaningful, must refer to an increase in the net flow of goods and services desired by the population, and not simply to an increase in the volume of some categories of physical output, regardless of the desire of the individuals comprising the society."

Professor E.F. Schumacher in his book Roots of Economic Growth: "Perhaps the best - perhaps even the only effective slogan for aid is: 'Find out what the people are trying to do and hlep them to do it better."

B. <u>Governmental Policies</u>

Let us turn to role of the State and consequential requirements re Governmental policies.

<u>Role of State</u>

Divergent views

In totalitarian countries monopoly in political power
Nothing new in that - Prevailed in Ancient Egypt, Sparta and Inca Peru

In free society State has two roles to play -
(1) that of an unpire who holds the ring and blows the whistle to prevent foul play and anti-social practices.
(2) minimum - By providing economic infra-structure and environment favourable to growth in ~~the~~ which peoples enterprise can build.

Dr. Ludwig Erhard, the creator of the "West German Miracle" describes the first role as follows:
"People are like football players, eleven on each side, playing the game to the best of their ability, competing with each other according to rules already fixed. The umpire watches the game very carefully to see that it is played according to the rules, but the umpire does not himself start playing football."

Professor Walter Eucken, described as the founder of the "social market economy", has the following observation to make in regard to the second role in his book, <u>This Unsucessful Age</u>:

"The State should influence the forms of economy, but not itself direct economic process. Concluding trade treaties, providing for an adequate monetary system, framing laws of patent and contract - all this lies within the purview of the State. The State should also decide the general nature of the economic and political order and thus meaningfully integrate the various sectors of economic policy; but it should not take upon itself the issue of production orders regulating the day-to-day manufacture, import and export of machines, textiles, wheat or other commodities, nor should it attempt direct control of labour.
"State Planning of forms - Yes; State planning and control of

the economic process - No! The essential thing is to recognise the difference between form and process, and to act accordingly."

Define infra-structure

Transport, communication, water, fuel and power, and technical education.

Mixed economy presupposes absence of monopoly and prevalence of free competition between State and free enterprises functioning on equal and autonomous basis

Advocated by MRM as far back as 1947 in Plea for the Mixed Economy in a talk to Bombay University. School of Econ. & Sociology – Silver Jubilee Lectures. State, not Public.

Planning

What Kind?

Term ambiguous

There is always some kind of planning

Issue is : What sort of planning and how much?

Line should be drawn between democratic and totalitarian planning

Does the model ~~that~~ result in command ecomony or one where "the consumer is king"?

Where consumer preference, economic law of supply and demand predominates, and market demand functions there is a free economy. No monopoly.

Ballot of the market place supplements political ballot - explain.

Such planning - Monnet Planning in France
NEDC In Britain
Holland etc

Professor Thomas Wilson, Adam Smith Professor of Political Economy in the University of Glasgow, aptly demonstrates the limits of such planning in a supplement to Crossbow (New Year 1962) entitled "Planning and Growth":

"If industrial output is to be centrally planned, this will have to be done in an economy where the market still operates and the freedom to buy and sell and make private contracts remains in tact over a wide range of activity. The problem then is to see how planning and the price system can be made to work together----It is worth reverting to the old description of the price system as a continuing plebscite designed to ascertain people's committee but to the judgement of those who buy the goods on the market. It is not easy to see how any other arrangement could ensure so large a degree of economic democracy."

Barbara Wooton, the Fabian Socialist: "Planning must know where to stop".

No such limits in communist system where NPC dictated what shall be produced, by whom it shall be produced and by whom it shall be sold.

Trotsky lived long enough to conclude, "The old slogan, 'he who does not work, neither shall he eat', is replaced by the new slogan, 'he who does not obey, neither shall he eat'.

~~Science~~ Balance of Soviet planning lop-sided
Priority for heavy industry
This not only reactionary, but uneconomic because investment diverted to least productive fields.

In U.S.S.R. planning has failed to deliver the goods after 40 years
Re: Housing and consumer goods – Gagarin, K's ball pen
Has exposed false dilemma - bread or freedom

April 1962 - National People's Congress in Communist China laid down new policy for "all round balance" between branches of economy "in the order of agriculture, light industry and heavy industry" c.f. S.P. Statement of Policy.

Taxation

In a free society major instrument of Government influence is fiscal.
What are the principles of sound taxation?

The latest report on taxation by the C.E.D.in the U.S.A., a very high level research and intellectual body lays down the principles of sound taxation in a form which is difficult to improve upon:

"Taxes must be high enough to cover the expenses of Government over the years, but not so high as to repress growth, or to inhibit risk-taking and individual initiative; high enough to create a surplus in prosperous times, that provides funds for private investment through retirement of government debt, and helps restrain inflation but not so high as to prevent the attainment of high employment."

"In under-developed countries need for incentives all the greater"

Parkinson's The Law and the Profits (page 95)

"With peacetime taxation amounting to over 10 per cent of national income, capital will begin to migrate. If its flight is prevented, whether by ~~next~~ circumstances, or by legislation, taxes can rise to 20 per cent but against a stiffening opposition which takes the form of tax avoidance and evasion carried to the utmost lengths of determination and skill. Above 20 per cent each tax increase will produce proportionately less. Above 25 per cent there is serious inflation, reducing the value of the revenue collected. Above 30 percent the decline ~~the~~ in national influence, observable long before to the expert, becomes obvious to the world at large. At 35 per cent there is a visible decline in freedom and stability. At 36 per cent there is disaster, complete and final although not always immediate. Taxation beyond that point, feasible and perhaps necessary in time of war, is lethal in time of peace. Of the taxation precipice, 36 per cent (for most countries) represents the brink."

Shenoy : "The choice is between less taxation and more social justice on the one hand and on the other more taxation and less social justice. We cannot have more taxation and more social justice at the same time. (Times of India, May 2, 1962).

Lerner expansion concerns.