PRESIDENTIAL ADDRESS

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Presidential Address

A Tale of Two Hands

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It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness . . . it was the spring of hope, it was the winter of despair . . . .

Charles Dickens : ***A Tale of Two Cities***

INTRODUCTION

This may not be the "worst of times" for the discipline of development economics, but this is also not the "best of times" for it. The discipline, rocked by a kind of schizophrenia that its votaries appear to be suffering from, is undergoing a painful, though not necessarily a Kafkaesque, metamorphosis. The consensus of the decades of the Fifties and Sixties about the nature and legitimacy of the discipline and about its 'world-view' has been seriously strained – indeed, according to some 'observers', already broken down. While the defenders of the faith [27; 36; 48] refuse to surrender, some of its erstwhile votaries [11] wish to force on the discipline a Carthaginian peace. And the dissenters [3; 24] have subjected its predictions and prescriptions to the "slings and arrows of outrageous fortune."

In the present Address I focus on the role of government in the development process which has become, of late, the central issue both in the academic ivory towers and in the corridors of power. In the cauldron of the controversy we find questions not only about the *form* of government intervention, but also about the need and desirability of any government intervention at all for promoting economic growth. Questions about the most appropriate 'form' of government intervention do nothing to undermine the discipline of development economics. This is because such questions relate to identification of specific types of 'market failures' caused by domestic- or foreign-trade distortions.

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The study of such distortions has always been accepted as the main concern of development economics. But the same is not the case when, on ideological and theoretical grounds, the legitimacy and relevance of government intervention *per se* are questioned *because* the questioning amounts to denying the existence or relevance of 'market failure' in the developing countries. Indeed, such a claim shifts the blame for causing such distortions to government intervention. This charge is fundamental; for, if true, it threatens the very philosophy of planned development that has been accepted by common consent as the headstone of development economics.

But, is there any empirical reason for supposing that the process of development in the developing countries has been held back by government intervention *per se?* As far as I know, no simulation exercise has ever been done to establish *quantitatively* that the Invisible Hand of the free market would have succeeded where the Visible Hand of the government has allegedly failed. Of course, some studies based on cross-country comparisons may point to the relatively greater success at attaining development of those countries which relied less on government and more on market. But, at best, such studies provide no more than *qualitative* judgements of a dubious kind. Furthermore, such judgements cannot be made a basis for proving the much stronger claim that government intervention *per se* has been counter-productive.

And, if by calling government intervention "counter-productive" it is meant that developing countries have economically fallen behind rather than gone forward, then this claim is patently false. For, indeed as Bhagwati [7] reports, there is nothing in the three decades of experience of development to suggest "increasing immiserization or even stagnation in the living standards of the poor." In fact, a look at the World Bank's Development Reports would show that the rates of growth of per capita income in many developing countries have been quite respectable by 'historical' standards, and that the intensity of poverty has been alleviated somewhat, though to a varying degree, wherever economic growth has occurred. For instance, the actual per capita growth rates achieved by Pakistan and India would have appeared like a midsummer night's dream at the time of their independence from colonial rule. Colin Clark [13] reports that in 1947 there was a consensus among economists that the Indian economy would at best achieve a long-run growth rate of 0.5 percent. Pakistan's growth possibilities were considered to be much worse than those of India.

What are the factors, then, which explain the winter of discontent that appears to have gripped development economics and its practitioners? Especially, why do many development economists now feel that the days of big government – i.e. of the Visible Hand – are now over in the developing countries, and that it is mainly through the mediation of the Invisible Hand that the developing countries can attain economic salvation? True, as Meier [32] points out, there have been "disappointments" experienced by development economics. Unacceptable rates of population growth, a fairly high level of absolute poverty and visibly large differences in income and wealth continue to darken the face of the societies in developing countries. But meeting these problems squarely requires an extension of the problem canvas of development economics, and an appropriate policy response. The free markets do not necessarily offer a panacea for such structural problems, which can only be rectified by appropriate government intervention.

Even though in the realm of ideas one can easily mistake correlation for causation, it would not be rash to suggest that the 'rebel' group among development economists is being fed, or at least supported, by distinguished economists, like Robert Lucas Jr. and Thomas Sargent, of the "new classical macroeconomics" school, who trace their lineage, through Milton Friedman, to Adam Smith but omit from their family-tree such insignificant characters as John Maynard Keynes! They also regard government as merely an instrument of vested interests who, by exerting political pressure, consolidate their hold on the existing economic system. Even though these names are not always explicitly spelled out in the development literature, I, like Sherlock Holmes, would suggest that it is their very absence which makes them "significant".

While these gentlemen of the new classical school have made some excellent contribution to economic theory, their work cannot be used as a model for the developing countries, much less adopted as a basis for policy making. In my opinion, the philosophy of planned development, preached and practised in the last three decades, is based on sound economics. True, in the light of the feedback from reality this time-tested development philosophy needs to be refined and made more comprehensive and 'balanced', but it does not require any fundamental restructuring. Specifically, in a "mixed economy", which such a philosophy has always tacitly accepted as the most plausible institutional framework for the developing countries, the Invisible Hand must continue to work under the apprenticeship of the Visible Hand. A reversal of this relationship will, I think, lead to an anarchic behaviour of the former.

Let me now tell my story more slowly.

THE MAKING AND UNMAKING OF A CONSENSUS

Evolution of a Consensus

During the decades of the Fifties and Sixties, a near consensus evolved round a philosophy of planned development, which incorporated the basic features of the Harrod-Domar growth theory and the Keynesian theory: while economic development was assumed to be a function of (physical) capital formation, the problems created by the inadequacy of effective demand were also recognized, though not always adequately emphasized. Its central prescription was "balanced growth". Made prominent by Ragnar Nurkse [39], the "balanced growth" hypothesis was first spelled out in Rosenstein-Rodan's "big push" conjecture [42]. While the hypothesis put forward by Rosenstein-Rodan and Nurkse envisages only a balanced growth of the various components of the industrial sector – "a wave of capital investments in a number of different industries" – its basic message is that the key sectors of the economy should grow harmoniously to make full use of the inter-sectoral feedbacks for the purpose of accelerating economic growth. Arthur Lewis's dual-economy model [28] sets up a (re)allocative mechanism to achieve a dynamic balance between the agricultural sector and the industrial sector. It puts at the centre of the development process the reallocation of labour from the agricultural sector to the industrial sector because the marginal productivity of labour is higher in the former sector than in the latter sector. This process of reallocation of labour between the two sectors would continue as long as the wage rate in the industrial sector is higher than in the agricultural sector and the price of capital services in the former remains high and positive. One of the most fruitful generalizations of the hypothesis put forward by Rosenstein-Rodan and Nurkse is suggested by Chenery [10] in his programming approach to resource allocation, according to which the key problem is that of "balancing supply and demand for different commodities and factors of production." This approach, using input-output analysis, provides a check on the consistency and feasibility of specific development plans. It also allows computation of shadow prices associated with given investment programmes and, by using them, permits an explicit analysis of the possibilities of improving a given investment plan.

The basic point to be noted in the present context is that a balanced growth of the various components of the industrial sector or of different sectors of the economy cannot possibly be brought about by the Invisible Hand of free markets alone. Nurkse was clear on this point. "Economic progress is not a spontaneous or automatic affair. On the contrary, it is evident that there are automatic forces within the system tending to keep it moored to a given level." Rosenstein-Rodan [41] was equally candid on this point. "The programming of investment in a developing country is necessary to correct for such distortions as indivisibilities, externalities, and information failures. 'Programming' is just another word for rational, deliberate, consistent, and coordinated economic policy." Hence the need for taking a planned route to development.

Subsequent writings of development economists have emphasized the preponderant role of government in managing the process of economic development. Raul Prebisch [40] clearly envisaged "an active role" for the State in development planning, which was needed to induce "structural change" and to "intensify the rate of internal capital formation". Mahalanobis's model for India [31] envisaged a policy-induced – indeed, policy-pushed – development of heavy industries to accelerate capital formation and economic growth. Of late, Mellor [33] and many other writers have emphasized the point that to promote a balanced sectoral growth it is essential to pursue a deliberate policy of raising the real income of the rural poor by keeping the price of food lower *than would prevail in the free market.* Similar reasoning appears in a recent World Bank study, entitled *Poverty and Hunger* [52]. Such development economists have revealed their preference for the Visible Hand while not de-emphasizing the beneficial role of the Invisible Hand. That policy-makers have dutifully accepted this advice is evident from the large number of plans that have guided development efforts in developing countries.

This middle-of-the road philosophy of planned economic development has been founded in good economics, with an eye to the ethical problems of economic growth which normally arise in the essentially (mixed) capitalistic societies that we have in the developing countries. The planned route to development has been chosen because, while free markets by themselves may lead to a Pareto-optimal constellation of production and consumption – i.e. a state in which not everyone's welfare can be increased simultaneously, so that if someone is to gain, others must lose – such an optimum is not unique. There may be many such optima, depending on the desired distribution of income. Hence, the free market can maximize social welfare only if it is supplemented by mechanisms of social control regulating the distribution of income and wealth. By itself, the free market cannot grind out 'globally' optimal social choice. That 'rational' individual behaviour does not always lead to an 'optimal' solution becomes most obvious in the cases in which choices among alternative courses of action have to be made under conditions of uncertainty. Such a possibility is neatly illustrated by the parable of the Prisoner's Dilemma – i.e. a situation in which both the prisoners ('rational' utility-maximizers) get the worst of all the possible worlds because they acted selfishly rather than in concert.

Seeds of Discord

The Early Dissenters: There have been dissenting voices against the ruling paradigm from the very beginning of the new discipline. Indeed, among its founding fathers, Hirschman calls himself a "second generation dissenter". He pictures himself as fighting a "major battle in his *strategy* against the widely alleged need for a "balanced" or "big push" industrialization effort" [18]. Accordingly, his "unbalanced growth" hypothesis was a search for "hidden rationalities" in the "processes of growth and change already under way". With the help of backward and forward linkages, unbalanced growth would generate latent entrepreneurial talents to energize an otherwise dormant economy. Clearly, Hirschman did *not* prescribe that sectoral imbalances should be deliberately engineered. Galenson and Leibenstein's advocacy of their "critical minimum effort thesis" [15] put the capitalist at the centre of the development process. They and, subsequently, Kaldor [20] asserted that since a wage-earner's marginal propensity to save was nearly zero and that of a capitalist close to unity, growth equilibrium would be determined exclusively by the saving rate of the capitalist.

But the dissenters never went so far as to discount completely the role of government in economic management. Hirschman remains skeptical of the efficiency of the Invisible Hand; and the idea of a "strategy" implied, even though he did not say so explicitly, some effort by the government to call forth and enlist "development resources and abilities that are hidden, scattered, or badly utilized" [19]. What he was fighting against was the 'myth of Integrated Investment Planning'. Also, in the Galenson-Leibenstein scenario the State is supposed to support the capitalist through fiscal and monetary policies, and to guide him through specific investment techniques and criteria. Thus the prevalent consensus in favour of the Visible Hand was never seriously questioned, even though the dissenters did not confirm it either.

It is not until the onset of the Eighties that we find some, if not all, of the dissenting development economists pushing aside the Visible Hand and proclaiming in its place the Invisible Hand as the undisputed ruler of the economic universe in the developing countries. However, in the rebellious crowd of skeptics and dissenters it is important to distinguish economists whose main concern is about an appropriate 'form' of government intervention from the agnostics who would throw government into the pit even for the 'sins' it never committed.

The Loyal Opposition: In the first group of development economists are included mostly advocates of the so-called "neoclassical political economy". For economists like Bhagwati and Srinivasan [8] and Anne Krueger [23] the problem is to choose optimal 'form' of government intervention according to the merits of the case. When they prove that *quantitative* trade restrictions give rise to a lot of activities of unproductive "rent-seeking" type, or of "directly unproductive profit-seeking" (DUP) type, an important implication of their analyses is that such restrictions ought to be replaced by tariff restrictions. Alternatively, to remove specific types of distortion, tariffs need to be replaced by export subsidies or by optimal tax-cum-subsidy policies. The effect of many of these suggested 'reforms' is to lower the overall incidence of government intervention, not to eliminate it altogether. These are most valuable insights, which amend the original consensus significantly, without really destroying it altogether. It is important to distinguish between government intervention that is beneficial and that which is not beneficial.

However, some members of this new school come perilously close to opposing government intervention *per se*. For instance, Brock and Magee [9] conjure up the "Invisible Foot", a kind of Frankenstein created by the Visible Hand, which, in the developing countries, is found trampling upon the Invisible Hand. Theoretically, in this scenario rent-seekers, encouraged mainly by sub-optimal government policies, prevent the forces of free competition from maximizing social welfare through the good offices of profit-seekers, i.e. the ones whose profits can be eliminated by perfect competition. But exactly how we distinguish the rent-seeker from the profit-seeker in the market-place remains an open question.

The 'Rebels': Among the rebels are those who threaten to demolish development economics altogether with their opposition to *all* government intervention on the ground that the fact of 'market failure' does not mean that government will also not fail in similar circumstances. Among the earliest rebels is P. T. Bauer, the writer of the well-known book, *Dissent on Development* [3]. He remains to this day a model agnostic in adopting an idiosyncratic posture that is extremist to the point of being bizarre. Indeed, he accepts *nothing* that development economists say or do. It may be interesting to quote a couple of relevant passages from a recent summing up that he has done of his own work "I noted then that comprehensive central planning was certainly not necessary for economic advance; it was much more likely to retard it." Instead, he remains convinced to this day that, just as in the plantation economies of the then British West Africa that he visited and wrote about in the 1930s, economic development has occurred – and, if not, then it must occur – owing to "the individual voluntary responses of millions of people to emerging or expanding opportunities created largely by external contacts and brought to their notice in a variety of ways, *primarily through the operation of the market*" [4] (italics mine).

Then there are those among development economists who, in their proselyting zeal, condemn all forms of government intervention as sinful. For instance, Lal [24] blames "the *dirigiste* dogma for the most serious current distortions in many developing countries", and explicitly rules out the possibility of steering "a middle course between *laissez faire* and the *dirigiste* doma". As such, he emphasizes that developing countries will be better off if thrown to the wolves of free markets than in the protective custody of the government. *Even* the theoretically justifiable 'forms' of government intervention are harmful because they tend to work perversely in practice. Hence, according to these economists, a strategic one-way shift from government control to free markets is the only way to achieve both economic growth *and* equity, for the simple reason that government intervention itself is responsible for the less-than-full realization of these policy objectives.

Where do these neophytes, though not the 'high priests', of the dissenting creed draw their inspiration from? To answer this question, I will be doing some eavesdropping in the development economist's backyard, where the bells of rebellion against the neo-Keynesian economics are ringing loudly – though, in my opinion, not very convincingly.

HAPPENINGS IN THE DEVELOPMENT ECONOMIST'S BACKYARD

The Dissolution of Neo-Keynesian Consensus

It is widely recognized that there is a crisis in economic theory. Bell and Kristol, in their book, *The Crisis in Economic Theory* [6], clearly suggest that the "house that Keynes built" appears to be in disarray, and that the neo-Keynesian synthesis, elaborately forged by Hicks, Samuelson, Tobin, Modigliani and many others to reconcile Keynesian macro-economics with the classical mirco-economics, is about to disintegrate (?).

I will not delineate in detail the dimension of this "crisis" but would say enough on this difficult subject to prove my contention that there is a connection between the reported crisis in neo-Keynesian economics and the prevailing schizophrenic confusion among development economists about the fruitfulness of a policy of planned development.

The Bone of Contention: The main character that appears in the mortal conflict between the monetarists and those who call themselves "rational expectationists" (or "ratex") on the one hand and the neo-Keynesians on the other hand is the Visible Hand. Arjo Klamer notes on the very first page of his excellent book, *The New Classical Macroeconomics* [22], that the basic question being addressed by the two adversaries is: "Can the government help to stabilize the economy through active, interventionist policies?" As Franco Modigliani [34] clearly states, while the neo-Keynesians have advocated an active interventionist policy for stabilizing the economy through fiscal and monetary policies, the monetarists and rational expectationists say the opposite. According to this latter group, there is no need to stabilize the economy as stabilization attempts are more likely to increase instability than to decrease it, and "the government should not be entrusted with the necessary powers" to make such attempts even if they are beneficial.

The Contenders for the Throne

The Progeny of Keynes: The neo-Keynesians are unambiguously persuaded that a "mixed economy", which is the common characteristic of *all* the countries outside the communist bloc, requires redirection and control by the government. James Tobin, neatly summarizing the neo-Keynesian position, says: "I think the basic issue there is the question of whether there are any dead-weight losses or market failures of a macroeconomic nature in a market economy. Neo-Keynesians think that there are and that the government can do something about them" (see Klamer [22, p. 101]). Associated with this vision of a "mixed economy", which, according to the neo-Keynesians is *not* inherently self-equilibrating, is a deep concern about promoting a socially desirable income distribution that the free market, if left to its devices, cannot take cognizance of. Hence, according to Tobin, "a neo-Keynesian seems to be more concerned about employment, jobs, and producing goods than people who have great faith in market processes." These social and political considerations provide an independent justification for government intervention in capitalistic (mixed) economies where income and wealth are, as a rule, unequally distributed. Fundamentally, the neo-Keynesians hold a relativistic view of human freedom, which must be constrained significantly to maximize social welfare. Samuelson [44] points out that in a free economy, where slavery is prohibited, "a man is not even free to sell himself: he must *rent* himself at a wage."

The Monetarists: The monetarists, by and large, reject such a world-view. According to Milton Friedman [14], the architect of the monetarist school, the economy is essentially self-equilibrating and self-regulating. Confirming the Aesopian adage, Friedman maintains that the apparently rigid wages are really not rigid, with the earth-shaking result that the Keynesian involuntary unemployment is not possible. Instead, full employment is achieved entirely through the Hicksian mechanism, powered by the 'required' changes in the real money supply. He views a(n) (competitive) economy, 'disturbed' by a (government-induced) demand stimulus, as adjusting itself to a 'natural' rate of unemployment entirely by the voluntary actions of wage-earners and producers. In Friedman's competitive wonderland, wage-earners initially do not 'see' the inflation-induced fall in their real wage, but producers do get a higher price of their produce and 'see' higher profits coming. Thus unemployment is reduced in the short run. But that is only a temporary phase which, being essentially an optical illusion, is undone by the voluntary actions of wage-earners who reduce the additional supply of their services at a lower real wage and contract for higher wages. This brief honeymoon, arranged by the government at public expense, must end because wage-earners refuse to consider it to be a honeymoon. As if to punish the myopic honeymooners, inflation rises even as the 'over-heated' economy simmers down to the natural unemployment-rate.

The Rational Expectationists: However, it should be noted that in the "adaptive expectations" model of Milton Friedman, there *is* room for the government to operate effectively along a short-run, negatively sloped Phillips curve. But his followers, led by Bob Lucas [29; 30], rule the government out of court even in the short run. As Haberler [16] sums up, this new nihilistic school "is best known for the startling conclusions ... to wit, that macro-economic policies, both monetary and fiscal, are ineffective, *even in the short run* ... it is the extreme antithesis of orthodox Keynesianism." Milton Friedman's adaptive expectations are, in these models, replaced by "rational expectations", which in effect seek to exorcise the Keynesian "animal spirits" from the world of expectations. If, instead, the mechanism through which economic agents form expectations are saddled with a 'rational' structure, revolutionary results would follow.

The revolutionary message of rational expectationists is essentially a call for macro-economic *non*-management! For the revolutionary economic agents, in reacting to government action, use up *all* the information that the government has access to. Thus, if government decides to increase money supply on the basis of a certain amount of information, the individuals already know that and alter their behaviour accordingly. Adjustment, therefore, occurs (almost) instantaneously and there is no room even in the short run for the government to alter the course of events. Individuals can randomly make mistakes, and it is only in such moments of transient informational weakness that, according to the so-called Sargent- Wallace proposition [45], (unanticipated) monetary shocks can produce any tangible effects on real macro-economic magnitudes.

But, as if to make sure that the successive errors of expectations are not serially correlated significantly, the smart actors in the rational-expectations models learn very quickly. Hence, they cannot be *systematically* fooled by the government about its intentions. Hence, systematic, anticipated monetary or fiscal policies will have no effect on output or employment. It would, therefore, be more efficient for the government to give up this hide-and-seek game of making an impact by misinformation. It should rather surrender to the super-rational economic agents – or, more accurately, Leibnizian monads – in Bob Lucas's model, who will take the economy, all by themselves, to a long-run equilibrium about which they form accurate estimates. Government intervention, according to Bob Lucas, is irrelevant because "this [U. S.] economy is going to grow at 3 per cent a year, no matter what happens. Forever." Here, at last, we have a vision of economic processes that is the closest possible approximation to the physicist's vision of an 'autonomous' universe. In conformity with the First Law of Motion, according to which physical bodies keep moving in the same direction and at the same velocity until something stops it, the economy is driven by mysterious laws of motion unless that "something" called the government stops it.

Note that in this Galilean vision of real-world economies no ethical issues arise from the fact that unemployment prevails because it results from the voluntary actions of wage-earners themselves. There can be no social injustice in such a self-equilibrating economy for the simple reason that government itself is the source of all injustice: Hence, Bob Lucas discounts any role for the government to resolve social injustice: "I can't think of explaining the pharaohs as being in existence to resolve social injustice in Egypt. I think they perpetrated most of the injustice in Egypt" (see Klamer [22, p. 52]). The implication of this cryptic remark is clear: the government is what it has always been – the source of all injustice.

THE SECOND COMING OF ADAM SMITH?

Having come that far, the rational expectationists cannot wait any longer for the Second Coming of Adam Smith. And why should Adam Smith himself wait in the wings any longer because his posterity has done for the Invisible Hand on an economy-wide basis what he could do for it only within the four walls of that damned "pin factory" of his?

Is He Coming to the Developed Countries?

If the world in the West, especially the U. S. A., is indeed like the one modelled by Friedman, Lucas and their clan, then let Adam Smith come there for a second time or the *n*th time. But most economists of the Keynesian persuasion would not grant landing rights to their father Adam Smith because the modern societies are not yet ready to receive him. (Perhaps they would not mind if he lands in the Chicago School and stays there happily ever after!) Franco Modigliani [34] clearly echoes the sentiments of all those not in favour of Adam Smith messing around with perfectly sane people in the 20th century when he says: "We must, therefore, categorically reject the monetarist appeal to turn back the clock forty years by discarding the basic message of the *General Theory*. We should instead concentrate our efforts on an endeavour to make stabilization policies even more effective in the future than they have been in the past." And there are many others, like James Tobin, Paul Samuelson, and R. M. Solow, who express similar sentiments. Indeed, Samuelson [44] would not allow the Invisible Hand to romp around freely even on the pages of his introductory economics text. While acknowledging the great beauty of Adam Smith's creation, he would "not go to the other extreme and become enamored of the beauty of a pricing mechanism, regarding it as a perfection in itself, the essence of providential harmony, and beyond the touch of human hands." (Read "human hands" as the Visible Hand.)

Lester Thurow, in his delightful book, *Dangerous Currents* [50], examines in detail the policy nihilism of the monetarists and of the rational expectationists, who really have carried it to absurd extremes. I would draw your attention to two implications of the rational-expectation hypothesis. Firstly, rational expectationists would not allow any possibility of improving economic performance by government intervention, except by mistake. For if there were any such opportunities, economic agents in Bob Lucas's model would already have acted upon them and eliminated them. Secondly, the policy nihilism of the rational expectationists, if carried to its logical end – or, shall we say, bitter end – would immobilize us all for ever. This is because if economic agents 'know' everything that government knows and does, not only would government intervention be unfruitful, but all attempts to *end* government intervention would be equally unfruitful, and for the same reason. Hence, by virtue of the omniscience of Bob Lucas's economic agents, who, like the proverbial elephant, do not forget anything, government's decision *not* to intervene would also be counter-productive, even though the decision to intervene was unfruitful in the first place. Hence, as Thurow observes, "policy makers should continue to make the decisions that they were making as if the rational-expectationist hypothesis were not true." That being the case, the Visible Hand, if it exists already, can, by the sheer logic of the rational expectationist's reasoning, continue to exist for ever!

Or is He Coming to the Developing Countries?

If Adam Smith is not being allowed to stage a Second Coming in the part of world to which he belonged, there is no reason why he should be allowed such a facility in the developing countries. The Far Eastern Four have often been cited as the possible countries where Adam Smith, or his ghost, can land to a tumultuous welcome. Yet, a closer look at these economies does not give any such indications. Especially the South Korean development has been helped by massive government intervention in all sectors of the economy to bring about in a very short time an equitable redistribution of assets and universal education. Export subsidization has been practised to encourage exports; but before then industrialization was of an import-substituting variety. Sen [48] has aptly remarked: "If this is a free market than Walras's auctioneer can surely be seen with a government white paper in one hand and a whip in another." At any rate, the South Korean case hardly fits in Bob Lucas's world-view according to which *all* government intervention is harmful.

Adam Smith's best hope is to (crash-) land on the paper models spun by the members of the so-called "neo-classical political economy" school. He can easily be drawn to Anne Krueger's "Rent-seeking Society", or be lured into Bhagwati's DUP's colony. But he cannot hope to stay there for long, because, as noted above, Anne Krueger, Bhagwati and Srinivasan are not necessarily arguing for ending government intervention altogether, but only for changing the 'form' of government intervention.

Unfortunately for Adam Smith, the developing countries cannot live by the logic of rational expectationists alone. Where problems of poverty-reduction require creative and effective policy-action to induce structural change, the problem of economic management can be solved not by eliminating the government – e.g. through a policy of massive deregulation – but by making it more effective. So, two cheers for the Invisible Hand, but no more. Let Adam Smith's soul rest in peace.

LET THERE BE MORE OF THE SAME

The brief and, admittedly, sketchy analysis that I have just presented has but one central purpose: to emphasize the "mixed-economy" characteristic of the developing countries. From the very beginning of the discipline of development economics it has been clearly recognized both by the founding fathers and by their sons (and daughters) that there is a place under the sun for *both* the Visible Hand and the Invisible Hand to work for the good of the society. This 'accommodating' attitude of development economists has been broadly consistent with, though not identical to, the neo-Keynesian prescription that *as long as aggregate demand is kept at the desired level,* free markets can be relied upon to function efficiently. Even though macro stabilization policies do not always figure very prominently in the strategy of planned development, its emphasis on government's role is very much neo-Keynesian. Unlike the Communist countries, the developing countries have never questioned the efficacy of the market mechanism as an information-gatherer: only such information has not been unquestioningly accepted, and wisely so, as a sufficient basis of the actual conduct of public policy. This is because free markets operate not in a vacuum but within a wider institutional framework. Also, there are many "external economies" which are not captured by market prices and whose pervasiveness vitiates the argument that government has no right to interfere with the working of the free market. However, a complete regimentation of the economy has also not been recommended by any responsible development economist.

That being the happy middle-of-the-road philosophy that most development economists recommended and policy-makers accepted by common consent, why should anyone who knows try to disturb such a state – though not a 'steady state' – of (near) consensus among development economists about providing a safe haven to *both* the Visible Hand and the Invisible Hand? As I have noted above, the example of the Far Eastern Four does not provide any grist to the dissenter's mill. If anything, the example of these countries points to the wisdom of a planned route to development. Also, there is nothing even in the economic history of the West, not even of England where Adam Smith was born, to support the case for an undisputed rule of the Invisible Hand. Leontief [25] points out that "To an insightful observer, such as Adam Smith, the entire national economy appears to be guided and protected by an Invisible Hand." However, this is an optical illusion because, according to Leontief, "the effective operation of the automatic price mechanism depended crucially on the nature of nineteenth century technology."

If the case for the free market, or even substantially free markets, cannot be substantiated empirically or historically, then why make it? The rational expectationist's thesis that government thrives only on the occasional lapses in the economic agents' informational faculties does make a net contribution to our knowledge: it replaces the Shakespearean 'weak' aphorism that "there is method in it [i.e. madness]" with a 'strong' statement that there is method *only* in madness. If the neo-Keynesians still like their Shakespeare, then, according to the rational expectationists, they are being needlessly anachronistic. Still, I make bold to say that I like my Shakespeare. In other words, I do not find the rational expectationists' logic relevant to the developing countries, even though it may be theoretically persuasive.

At any rate, such logic is not – at least, not yet – universally accepted even in the developed countries as a sufficient argument for ending the pervasive role of government. And there is much less reason for its being accepted in the developing countries, where 'market failures' are a rule rather than an exception, and where problems of structural change require active government 'intervention'. As Kenneth Arrow [2] has clearly stated, the "informational economy" achieved by the market system is not realized when no market exists to supply this information in the form of prices. The problem of the non-existence of markets, referred to in the literature as 'market failure', is especially acute with respect to "future goods", which pose questions of bread and butter to development economists. All such cases, to be found under every stone in the developing countries, warrant "government intervention; code of professional ethics; or of economic organization with some power intermediate between the competitive firm and the government." Thus even if, as Becker [5] warns, the governments are nothing but proxies for the vested interests whose interests they serve, let there be governments which are better and more enlightened. We cannot throw them out, if only because these proxies are more emenable to social control than the real thing!

At a deeper philosophical level, the view that individual freedom is an absolute good is not a tenable proposition. To ensure freedom for all, the (unlimited) freedom of the privileged class must be curtailed. Keynes put this point clearly: "A great deal is at stake ... we have to show that a *free system can be made to work.* To favour what is known as planning and management does not mean a falling away from the moral principles of liberty which could formerly be embodied in a simpler system..." (see Harrod [17, p. 570]; italics added). The task of modern societies is to find a delicate balance between individual freedom and social organization. A failure to achieve such a balance is sure to have disastrous consequences. Bertrand Russell, reviewing the historical and philosophical currents of the nineteenth century, wrote: "Liberals and Radicals alike failed to understand the part played by organization in a world ruled by scientific technique. Through this one failure, in spite of great increase in wealth, intelligence, and happiness, the century which they attempted to guide ended in disaster" [43, p. 509]. And this one failure may again condemn the twentieth century to debilitating contradictions, even to a complete disaster. This is especially true of the developing countries where basic social institutions are much weaker than in the developed countries to check the pulverising fall-out of individual greed.

We should thus have more of the same, for the simple reason that nothing better is available. We should continue to traverse the planned route to development to solve the problems of underdevelopment. As Bhagwati [7] rightly observes, "the reduction of poverty is now seen as a more complex and textured process than we had hoped for in the 1950s. But it is equally manifest that the claims that the correct strategy for raising the living standards of the poor was fundamentally mis-specified by us are without substance." That, in the light of the past experience, we should be making significant adjustments in the 'traditional' strategy of growth is only natural. Even though the earlier vision of a government as a benign, well-meaning entity has become somewhat blurred, to throw out a tried strategy of planned development lock, stock and barrel, or even to modify it drastically, would be both unwise and dangerous.

THE RAINBOW'S END

A stock-taking of past failures and successes should convince us that, for all its shortcomings, the strategy of planned development has served the developing countries well. If, in the words of Arthur Lewis [26], "the viability of LDCs in normal times, like the 1950s and the 1960s , is now beyond doubt", the credit for pulling this extraordinary feat must go to this time-tested strategy. With the passage of time, the 'original' message has to some extent been modified and diluted, but this has happened within the framework of the accepted development philosophy. Especially the recognition of the useful (supplementary) role that market mechanism can play in the process of development is an important addition to the literature on development economics. And there are many other aspects of the development process that must be recognized more explicitly within an (expanded) paradigm of development economics. I list only a few of them below.

(i) Thanks to the researches of development economists like A K. Sen [47], Mahmood Hasan Khan [21] and others, we now know better the 'dimensions' of the problems of poverty and starvation, especially in rural areas. It is clear that these problems need to be tackled from both the demand side and the supply side. Here, as elsewhere, we have the old Marshallian scissors at work and clanking. That the problem of extreme rural poverty can only be tackled within the context of a fast-growing agriculture should now be accepted as an axiom. But, while this is a necessary condition, it is certainly not a sufficient condition for poverty reduction. To make an effective attack on rural poverty, additional steps must be taken to buoy up the income (effective demand) of the poor by keeping the prices of food reasonably low, and by arranging for appropriate employment-generating techniques of production. These findings should also be accepted as axiomatic.

(ii) The writings of Theodore Schultz [46] and others make clear the importance of investing in people's health and education. The important role that human capital, in addition to physical capital, plays in promoting economic development and technological change should be recognized more explicitly than before in development models and policies. These processes must be promoted and backed by definite programmes to achieve universal education, especially technical education. All success stories of the countries which have done it – and they include such countries as Japan and South Korea – establish beyond all shadow of doubt that rapid economic growth can come about not only by increasing the domestic production of import-substituting *goods*, but also by acquiring *knowledge* about making those good better and cheaper. But such knowledge does not come by without the active support of scientists of all hues and colours, who first have to be created by an act of a conscious social policy. Once again, these 'facts' are also best taken as axiomatic.

(iii) No country that made a success of economic development could ever have done so without *first* producing deep changes in the basic institutions of the society, including those in the institution of private property. And changes in these institutions have invariably involved a radical, though gradual, redistribution of income and wealth brought about mostly by effective fiscal policies. And this has happened not only in socialist countries, but also in capitalistic countries. Roy Harrod, in his classic biography of John Maynard Keynes [17], quotes him as saying that modern *capitalistic* institutions cannot be saved without these societies accepting a substantial curtailment of the institution of private property *and* an increasing role of the State in economic management. In a study that I did with Asghar Qadir [38], we have conclusively shown, as was done by Adelman and Morris [1] earlier, that substantial structural changes in the existing pattern of the distribution of wealth, along with active egalitarian incrementalist policies, such as those proposed by Chenery [11; 12], are essential for reducing the unacceptable levels of economic inequalities found in the developing countries, and that without such changes taking place, the existing income inequalities will increase 'explosively' over time. Gunnar Myrdal [35], looking back on his thinking on development problems, concludes that "What is needed to raise levels of living of the poor masses is radical institutional reforms. These would serve the double purpose of greater equality and economic growth. The two goals are inextricably joined. This implies a fundamental difference from developed countries, where the two goals can be, and often are, pursued separately." Here we have a lucid statement of *why* developement economists should exist and for *what* they should exist.

(iv) We must accept the judgement of Jan Tinbergen [51] that "equity means *equality of welfare* of all individuals concerned." Self-serving definitions of equity, which seek to establish a correspondence between what an individual contributes to national income and what he receives from it, are no longer acceptable. It is clearly recognized that 'historical' factors, especially the size of wealth and the stock of education that you already have, determine how much you can contribute to the "wealth of nations".

However, to do all this, an active role of government in economic management must be accepted as a fact of life in the developing countries. For all his hesitations on this count, Arthur Lewis [27] admits that "What development economists cannot leave out of their calculations is the government's behaviour." Obviously, it would be naive to think that the elites in the developing countries, whose economic interests are preserved by the existing institutions, would voluntarily accept substantial changes in those institutions. A decisive government action is required to make a dent in the *status quo.*

True, revolutionary governments, born of revolutions, have brought about institutional changes by uprooting the existing social frameworks; but democratic governments have also brought about such changes, as the examples of Western Europe and the United States clearly illustrate. I would opt for the latter course of action, but would like to warn that obscurantism with respect to evolutionary processes has always led to revolutions. Let history not repeat itself in the developing countries just because we, like our forefathers, have refused to learn from it.

I tend to agree with Herbert Simon [49] that "if we want an invisible hand to bring everything into some kind of social consonance, we should be sure, first, that our social institutions are framed to bring out our better selves, and second, that they do not require major sacrifices of self-interest by many people much of the time." Unlike the developed countries, the developing countries have not, as a rule, succeeded in creating institutions which could ensure that the society did not continue to cause *only* the poor to shoulder the major burden of economic development *all the time.*

These are, then, the major challenges before development economists which I also tried to emphasize in my previous Addresses to this Society [36; 37]. Sociologists, political scientists and politicians should also lend a helping hand, but the votaries of the queen of social sciences – i.e. economists, especially development economists – must take the lead. Let them spread the light of knowledge to uncover the sordidness of our socio-economic environment, which exacts from the poor a complete obedience that destroys "genius, virtue, freedom, [and] truth, [and] makes slaves of men, and, of the human frame, a mechanized automation". It is only through such an awareness that purposive action can rescue from the dark caverns of deprivation and human degradation the majority of human race – the voiceless, unacknowledged makers of the society who, like Mitya in *The Brothers Karamazov*, "don't want millions; but an answer to their questions." As if to answer "their questions", let there be a heavy shower of material prosperity so that the have-nots can also behold the clear sky spangled with the stars of hopes. While there is still time to reverse the inexorable unwinding of 'fate', let the Two Hands work together creatively to modify and transform the sickening *status quo* in the developing countries – something that we have not been able to achieve so far. Let the 'Tale of Two Hands' have a happy ending so that posterity inherits from us not the "winter of despair", but the "spring of hope".

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