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The Anatomy of 'Failures'

SYED NAWAB HAIDER NAQVI*

"Give it an understanding
but no tongue."
William Shakespeare: *Hamlet*

Development economics, in its bid to attract the attention of the somewhat unchivalrous economists, has worn many masks in the intellectual ball that has been going on since 1950. And it has indeed been variously recognized by the dazzled economists – as a relentless pursuer of growth at all cost, Arthur Lewis (1954); a passionate advocate of economic justice and a purveyor of basic needs for the poor and the needy, Paul Streeten (1981); a crusader against 'dependency' on some real or abstract centre, Samir Amin (1976); a revolutionary with a cause to eliminate the last traces of imperialism, feudalism and capitalism, Paul Baran (1952); a tame balancer of growth, equity and individual liberty, Hollis B. Chenery (1983); and a pretender to the throne in a realm that rightly belongs to neo-classical economics, Deepak Lal (1983). Like a Cinderella in a hurry, it has taken as its dancing partners the State and the market, first jointly and then one at a time – asking both the visible and the invisible admirers to hold its hand. Some call this frequent change of masks and partners a sign of fickleness and opportunism, some see in these changes the handiwork of a 'compleat strategist', but to the 'Paretian liberal' these changes, in masks and partners, are a matter of indifference.

Not a silent watcher of events in the development economists' backyard, I have [illegible]ted, in my Addresses to the Inaugural Sessions of the Annual General Meetings of [illegible] Society, the foibles of the pretty first cousin of the Queen of social sciences. I [illegible] tried to discount the impression, created by such luminaries as Schultz (1981) [illegible] Hirschman (1981), that this first cousin – i.e. development economics – is some

*Professor Naqvi is Director of the Pakistan Institute of Development Economics, Islamabad.

This is a revised version of the Presidential Address which Professor Naqvi delivered at the [illegible]th Annual General Meeting of the Pakistan Society of Development Economists. He is [illegible]ful to Prof. Pan A. Yotopoulos and other participants of the meeting for their views and [illegible]ions. However, as usual, the author alone is responsible for any errors that may still remain.

Cinderella, who is doomed to depart from the scene with the first appearance of the morning star. Having done so, I have attempted to get a glimpse of its 'real' face, hidden behind the mask, with the help of such distinguished outside helpers as Imre Laktose (1970), Karl Popper (1934; 1959) and Thomas Kuhn (1962). I have even ventured, even at the cost of offending the soul of our father Adam Smith, to express an opinion on the characters, living and defunct, whose company development economics has sought and kept. And, like a jealous suitor, I have made anxious enquiries about the visible and invisible hands that it has leaned on.

Having made such enquiries last year, I now wish to have a second look, in today's Address, at the "government versus market 'failure' " debate, which has of late rocked the inchoate discipline of development economics to its very foundations. I have been prompted to do so by the opinion expressed on this matter by James Buchanan in his delightful book, *Liberty, Market and State* (1986). He has sought to put the government in the dock for its culpability in many an economic crime that, according to him, has darkened the face of the economic universe. He has even made the claim that "public choice theory did offer an intellectually sophisticated *government failure* analogue to the earlier *market failure* thrust of welfare economics" (p. 15, emphasis added). Coming as it does from a colourful Nobel Laureate, such claims cannot be dismissed lightly. Similar claims, which I reviewed in my last year's Address, "A Tale of Two Hands", have also been made by Milton Friedman (1968), Robert Lucas (1972), Gary Becker (1983) and other knights-at-arm of the Chicago School. But Buchanan has outsmarted them all in establishing his filiation from Adam Smith.

Buchanan's story of the alleged government failure is of special interest for development theory and policy because of his invocation of public-choice theory in support of his anti-*dirigisme* idiosyncracies. His discussion of the problem provides us with an altogether new viewpoint on the debate about the role of the market in the process of economic development. It also gives me a perfect handle to demonstrate that the public-choice theory does *not* provide any valid 'normative' or positivistic argument to justify the 'slings and arrows' of James Buchanan against government.

I begin my refutation of anti-*dirigisme* by discussing the principle of Pareto optimality, the violation of which to many neo-classical economists is "as if motherhood is under cruel attack", Sen (1984). A discussion of Pareto optimality, in turn, focuses our attention on such values as *anonymity, neutrality* and *unanimity*, which are prefigured in the royal *indifference* of the Paretians – who in their 'heartlessness' strongly resemble the Martians – towards such 'minor' questions as promoting an equitable distribution of income and wealth. I, then, move on to examine the relevance for development economics of other collective choice rules, like the maximin criterion of John Rawls, which focus explicitly on the question of social

justice. A consideration of these choice rules shows that the case for government failure to correct the inherent defects of the market mechanism does not stand on strong logical or moral foundations. In doing so, we will be traversing the "road not taken" so far by development economists, who tend to accept without question the absolute sovereignty of the Paretians in 'sophisticated' economic matters.

But, if only to hold your Paretian indifferentism in check for the rest of my address, I will not anticipate the entire story in these introductory remarks.

THE FRIENDS OF 'FAILURE'

To see the debate in a clear perspective, I will first recount briefly the story of failures in economics. Every student of economics is familiar with Pigou's demonstration of "market failure" to optimize social welfare in the presence of 'externalities'. But the arguments by Friedman, Lucas and Becker about government's failure to optimize social welfare are relatively recent, and not so familiar. I take up both these arguments before I proceed to a re-examination of Buchanan's argument from the vantage point of the public-choice theory. If economics is what economists do, you may also call this story an economists' autobiography of failures.

(i) Market Failure: Pigou and his Progeny

Pigou (1924) spelt out clearly the circumstances in which market 'fails' to optimize social welfare, and the implications of this failure for government's behaviour. Briefly, the presence of external economies (and diseconomies), by driving a wedge between social and private benefits (and costs), prevents the market from sending price signals of the right magnitude to economic agents. Because of this 'misinformation', a regime of perfect competition fails to optimize social output. Under these circumstances, the government must, therefore, intervene in order to offset an inherent defect of the market machine for delivering the goods.

Scitovsky (1954) has discussed at length the phenomenon of externalities in the context of the developing countries. He notes that to the "general rule" that private profitability of investment is a reliable indicator of its social profitability, "the exceptions are too great and obvious to be ignored, especially in underdeveloped countries. . ." He then concludes that "The proper co-ordination of investment decisions would, therefore, require a signalling device to transmit information about present plans and future conditions as they are determined by present plans; and the pricing mechanism fails to provide this."

The case of public good illustrates the problem of market failure more clearly. Public goods – e.g. operation of military establishments, administration of justice, provision of free education – have been defined by Musgrave (1959) as "goods and

services, whose *inherent* quality is such that they cannot be left to private enterprise" (p. 43). According to Samuelson (1969), the central feature of a public good, characterized by joint supply and indivisibilities, is that "each individual's consumption leads to no substraction from any other individual's consumption of that good." But, because of this wonderful plasticity of public good, it is in each individual's interest that *all* contribute to the production of such good, but that each individual would be also better off if *only* he does not pay. Here we have the happy-go-lucky 'free rider' who cannot be excluded from the consumption of the good through the market mechanism. This property of inexcludability, in turn, makes it difficult to devise (voluntary) co-operative strategies to make the free rider pay for his 'lunch', through his nose, if necessary. And, as Olson (1965) shows, when communities are large, voluntary co-operative agreements among individuals will not solve this problem, and the phenomenon of free riding will lead to the underproduction of the public good. Government intervention is clearly indicated in such cases.

(ii) "Government Failure": Friedman, and Rational Expectationists

In my last year's Address, "A Tale of Two Hands", I examined at length the anti-government sentiments of some distinguished economists of the rational expectationist school like Milton Friedman (1968), Robert Lucas (1972) and others. Here I briefly summarize that discussion. Friedman (1968) and others have advocated that, driven by the behaviour of egoistic individuals and working through an adaptive-expectations mechanism, market is self-regulating. Macro-economic management is, therefore, redundant. It is also a nuisance because government's efforts to minimize unemployment through a demand stimulus will only end up with increasing inflation.

But Friedman sees a role for government in the short run because the expectations of wage-earners are 'adaptive'. Not so, for his followers. The rational expectationists will not concede, even in the short run, to the *inherently* ineffective government. The utility-maximizing Leibnizian monads in the rational expectationists' wonderland use up all the information that is available to the government. The market, therefore, adjusts itself instantaneously to the macro-economic initiatives of the government – e.g. an increase in money supply to cure unemployment. The government intervention is redundant because whatever the government does, even in the darkness of the night, the wide awake, atomistic, and omniscient economic agents know about it already, and can easily beat the government in its court. Hence, as Lucas has asserted, "*This U.S. economy is going to grow at 3 percent a year, no matter what happens. Forever*" (1984).

The rational expectationists are not alone in their nihilism when it comes to assigning any constructive role to the government. Some development economists

have also used anti-*dirigisme* as their trade mark. Prominent among this clan is P.T. Bauer, the writer of the well-known book, *Dissent on Development* (1972). He remains unrepentant to this day about his anti-government posture. It may be interesting to quote a couple of relevant passages from a recent summing up 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" (Bauer 1984, p. 42). Instead, he maintains, economic development occurs – and, if it does not occur, then it *must* occur – as a result of "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*" (Bauer 1984, pp. 30-31) (italics mine).

P. T. Bauer's views may sound extremistic but he has many sympathizers, if not followers, among development economists. Such economists maintain that government intervention is harmful *even* in cases where the market fails. Hence, according to these agnostics, a one-way strategic shift from government control to free market 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!

As opposed to the positivistic arguments just related, I now turn to Buchanan's 'normative' arguments for government failure.

THE ANTI-*DIRIGISTE* 'GOSPEL' ACCORDING TO JAMES BUCHANAN

Buchanan raises his anti-*dirigiste* castle on normative foundations – essentially the "unanimity" principle. He harks the deluded economists back to the fold of [Ada]m Smith. Let us hear what he has to say in support of a gospel so anachronistic [i]s intent.

[Bu]chanan and Adam Smith

Looking back with considerable anger on his failure, in 1957, to set up in the [Unive]rsity of Virginia "a community of scholars who wish to preserve *a social order [based] on individual liberty*", he states that such an aim could be achieved only by a '[resear]ch programme' that helps economists to return to the cold embrace of Adam [Smith']s utilitarian philosophy. "To us, quite simply, political economy meant [nothin]g more than a return to the stance of the classical political economists", and [Adam] Smith's propensity to truck and barter one thing for another [should be] the focus of our research and enquiry."

[W]hy should Buchanan take such an anachronistic track? Would he not thereby [con]demning himself to practising, in the terminology of Imre Laktose, a "degen[erate] Scientific Research Programme (SRP)", as opposed to a "progressive SRP"

with a greater "empirical content"? Buchanan remains unimpressed. Focusing on "catallactics", the science of exchange, a born-again Buchanan returns to the fold of Adam Smith, *because* this is the only way to behold in full view the "principle of spontaneous order, or spontaneous co-ordination, which is, as I have often suggested, perhaps the only real 'principle' in economic theory as such." And, for that reason, "economics should concentrate more attention on market arrangements."

One would naturally ask, would such an overwhelming concern with market arrangement not be extraordinarily conservative? Buchanan does not think so. Going much beyond the claims of a typical "Paretian liberal", he lays down that "choices in the market are not arbitrary, that there are narrow limits on the potential for exploitation of man by man, that markets tend to maximize freedom of persons from political control, that liberty, which [is the] basic value, is best preserved in a regime that allows markets a major role."

Within the Buchanan-Smith catallactic framework, economic power becomes meaningless in a world of atomistic buyers and sellers, such as perfect competitive markets provide. Buchanan, therefore, posits a *normative* judgement that "voluntary exchange among persons is valued positively, while coercion is valued negatively; and hence the implication that the substitution of the former for the latter is desired. . ." From this normative judgement, it is a short step to assert the "failure" of the government, which to him represents an exercise of power to force *non-voluntary* agreement among economic agents.

Buchanan appears to have outdone Adam Smith, who had clearly stated that "People of same trade seldom meet together, even for amusement and diversion, but the conversation ends in a conspiracy against the public or in some contrivance to raise prices".

(ii) Buchanan and Tullock

Between Buchanan's *Liberty, Market and State* (1986) and Buchanan and Tullock's classic, *The Calculus of Consent* (1962), there is a logical connection. The principle of unanimity based on the process of *voluntary* agreement among individuals is common to both economic and political processes. Buchanan and Tullock in *The Calculus of Consent* (1962) maintain that "The individualistic theory of constitution we have been able to develop assigns a central role to a single decision-making rule—that of general consensus or unanimity. . ." (p. 96). According to Buchanan, the same single decision-making rule also applies to economics, as market processes can be construed as signifying unanimity about all kinds of market outcomes, *even* the socially unjust ones. This is because such outcomes can also be seen as symbolizing a *lack* of unanimity about *changing* an unjust state of economy – since even *one* person can veto a 'just' change. In such a situation, according to the unanimity principle, *status quo* should be the preferred outcome!

That such conservatism, allegedly rooted in a 'scientific' *sang-froid*, can also lead to a social upheaval, or even a full-scale social revolution does not seem to bother Buchanan. Indeed, if confronted with such a problem, I guess, he would rather take this as yet another example of the inherent 'failure' of the government to prevent such unsavoury social or economic outcomes! Here Buchanan may be right; but it should be remembered that, in a revolution, markets also fail – indeed, they go up in smoke along with all other anti-change institutions. Since I *am* bothered by such an eventuality, I would strongly prefer a decision-making rule that does not have such unpalatable social consequences.

But, before I go any further, let me take a closer look at the principle of Pareto optimality, which has been used by economists, especially the neo-classical nihilists, as a sure-fire argument against *dirigisme*.

A 'HEARTLESS' COLLECTIVE-CHOICE RULE

Buchanan's diatribe against a *dirigiste* solution to economic problems has one positive lesson for the development economist: it is to focus his attention on the problem of selecting a collective-choice rule appropriate for a typical developing country. It is, indeed, odd that the literature on development economics has paid scant attention to the problems raised by the theory of collective choice in the context of maximizing social welfare. This is odd, because, in a mixed-economy framework, which does not take 'society' as an entity independent of its individual, it is of utmost importance to look for reasonable and workable rules for relating in a non-dictatorial fashion *individual* preferences with *social* preferences – which is the subject-matter of the theory of collective choice.

(i) Pareto Optimality as a Collective-choice Rule

Pareto optimality is essentially a collective-choice rule. If there are states of economy a and b, and there is at least one person who prefers a to b while everyone is indifferent to both a and b, then a is Pareto-wise superior to b. Pareto optimality is satisfied if in a set A there is no alternative which is Pareto-wise better than a. On this definition, everyone in the society is indifferent to both a and b.

The relevance of Pareto optimality as a collective-choice rule has not been generally discussed by development economists, but the rule appears to have been accepted without question by many development economists. For instance, Lal (1983) recommends that the allocational principles of welfare economics, based on the principle of Pareto optimality, should *replace* development economics because of the observed 'failure' of the *dirigiste* prescriptions of the latter. However, such statements are even logically unacceptable because these formulations contradict the celebrated Hume's Law, which prohibits basing prescriptive (normative) conclusion

on factual premises *alone*. Also, as I will show presently, an uncritical acceptance of Pareto optimality as a collective-choice rule would have politically and economically unacceptable implications for the simple reason that it is distributionally neutral and is anti-change.

(ii) Pareto, Market and State

The principle of Pareto optimality has distinct anti-*dirigiste* overtones. The so-called Invisible Hand Theorem states that "Every competitive equilibrium is a Pareto-optimum; and every Pareto-optimum is a competitive equilibrium." This theorem clearly establishes that Pareto optimality and competitive equilibrium are birds of the same feather, and that, mathematically speaking, they fly together without requesting any escort from the government. Indeed, government intervention is redundant because an economy in competitive equilibrium is, by definition, "unimprovable". If the attainment of Pareto optimality is a necessary (perhaps also a sufficient) condition to maximize social welfare, then free markets, powered only by the irrepressible utility-maximizing egoistic individuals, would surely achieve such a social objective. Indeed, they will do so, by virtue of the manner in which self-interest of the atomistic economic agent is *defined*.

(iii) Does Pareto Optimality Denote a "State of Bliss"?

If, God forbid, Pareto optimality should become the ultimate social objective to be aimed at – and much of modern welfare economics is based on such a weird exhortation – then what that woe-begone society will have in store for its members is a very parsimonious feast. Indeed, in extreme cases, there will be no feast at all for the majority of the members of a society hell-bent on achieving Pareto optimality. For an economy ensconced in a Pareto optimum could keep its cool, with a good 'conscience', if those who are deprived of the basic necessities of life, like food, *cannot* be made better off without depriving, even modestly, the rich of their 'hard-earned' wealth (or income)! In such extreme cases, the Pareto-optimality rule had better be called the Czarina decision rule!

Another property of such an elitist state of bliss is that the society is indifferent to the multiplicity of Pareto-optimum points. This is another way of saying that such a state signifies unanimity – a property central to Buchanan and Tullock's *Calculus of Consent*. But is such a state worth calling a state of bliss? Not by the standards of the ordinary mortals like myself, if only because Pareto-optimality points are neutral with respect to any reasonable distributional considerations. If the purpose of such a collective-choice rule is to instil in the poor the qualities of stoicism and contentment, then this mathematical state of bliss should be renamed Pareto purgatory.

Pareto optimality, as a collective-choice rule, is also deficient because it does not work in the presence of externalities. A typical case, which I discussed above, is that of public goods where the free rider cannot be excluded from the consumption of this good through the market mechanism. Since in this case it is in everybody's interest to understate the benefit one expects to receive from the consumption of this good, a public project producing such a public good will be defeated in an open election even though it maximizes social welfare. Since public goods are crucial elements of the investment programmes in the developing countries, Pareto optimality would lead to lower growth as well as equity.

This clearly shows the inadequacy of the Paretian principle. As Sen (1970) points out, "an exclusive concentration on Paretian consideration has, on the one hand, confined traditional welfare economics into a very narrow box, and has, on the other hand, given it a sense of ethical invulnerability which does not seem to survive a close scrutiny." What will also fail to survive on close scrutiny are the normative props on which the case for an unequivocal preference for market arrangements rests.

GENTLEMEN PREFER RULES WITH A 'HEART'

A relevant point about Pareto optimality is that it is *not* a universally true principle of collective choice which will hold good *irrespective of the nature of the society.* Indeed, as I will show a little later, there are other collective-choice rules which should be more acceptable to the developing countries, because considerations growth as well as equity are even more important in the developing countries than the developed ones owing to the fragile social institutions of the former. (This is to assert that Pareto optimality is any more relevant as a decision-making rule for developed countries.)

Another important point in the present context is that even a voluntary, but ive, acceptance of a collective-choice rule, like Pareto optimality, does *not* antee that it will also be endorsed if other more acceptable collective-choice were also available. A seeming acceptance of the *status quo* is not a vote for its tuation, especially when possibilities exist to change the *status quo* by adopting rent choice rules.

I now turn to a consideration of alternative choice rules which may be more ant for the developing countries because of their emphasis on the element of ity in an individual's behaviour and on the right kind of institutions, and which ese reasons may win a voluntary endorsement. There are many such rules, are discussed at length in Mueller (1979) and Sen (1970). But here I present ur consideration only two such decision-making rules.

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I now turn to a consideration of alternative choice rules which may be more relevant for the developing countries because of their emphasis on the element of morality in an individual's behaviour and on the right kind of institutions, and which for these reasons may win a voluntary endorsement. There are many such rules, which are discussed at length in Mueller (1979) and Sen (1970). But here I present for your consideration only two such decision-making rules.

(i) Harsanyi's Social Function Welfare

Within the utilitarian framework that underlies the Pareto optimality principle, Harsanyi (1977) proves the remarkable result that social welfare is a function of the weighted average of individual welfare. The remarkable aspect of Harsanyi's proof is that, unlike the Pareto-optimality principle, it explicitly achieves the coveted result on normative grounds. The motivation of Harsanyi's research is to provide an insight into how collective decisions *ought* to be made. To this end, Harsanyi postulates that individual's preferences are divisible into *personal* preferences and *moral* or *social* preferences. In making known his *moral* preferences, an individual is supposed to reflect the preferences of every other individual by putting himself in the position of the other individual.

Two points should be noted here. One, Harsanyi individuals are not the 'heartless' egoistic individuals with Paretian idiosyncracies; they are concerned individuals who wish to make their decisions in an *impartial* fashion. Two, if the world is such that Harsanyi individuals' decisions carry a significant weight, as opposed to those of the Paretian individuals, then this world is very different from Adam Smith's world or the one that James Buchanan prefers. Note that this is not the world where the Invisible Hand of the market is the only purveyor of the good things of life.

(ii) The Rawlsian Collective-choice Rule

Unlike the Pareto-optimality rule, John Rawls breaks new ground by rejecting utilitarian philosophy and social-welfare-function approach based on this philosophy. His *Theory of Justice* (1971) is perhaps the most complete modern exposition of the contractarian philosophy of Rousseau, Kant and many others.

The most distinguishing feature of the Rawlsian analysis, which makes it especially attractive to development economists, is its insistence on the creation and establishment of just (and progressive) *institutions* relating to the "basic structure of the society". Within the framework of such institutions, collective decision-making will ensure a just "assignment of fundamental rights and duties", and a morally right "division of advantages from social co-operation." Unlike the Paretian approach, which condones (big) welfare losses of some if these can be (notionally) compensated by (big) *potential* gains of others, the Rawlsian theory does *not* allow for such potential trade-offs: "Justice denies that the loss of freedom for some is made right by a greater good shared by others." Instead, the theory insists that the needs of the least-privileged individuals in the society, measured by an adequate supply of "primary goods", must be satisfied *first*. These primary goods are identified as the "basic rights and liberties, powers and opportunities, income and wealth".

The Rawlsian framework is based on two analytically related but separable principles. The first is the fundamental notion of "justice as fairness", which

requires that individuals choose 'just' rules from a hypothetical "original position" of complete equality. Analytically speaking, this "original position" is reached by stepping through a "veil of ignorance" that hides from the individuals in the original position all the advantages that may accrue to them from their own decisions. This analytical procedure highlights the basic importance of *impartiality* for ensuring that the rules of justice so chosen are "fair".

Then, from this position of primordial equality, two fundamental principles of justice flow: (a) "Each person is to have an equal right to most extensive basic liberty compatible with a similar liberty for others"; (b) "*Inequalities are arbitrary* unless it is reasonable to expect that they work for everybody's advantage, and provided that the positions and offices to which they attach, or from which they may be gained, *are open to all*." (italics added)

As discussed by Sen (1970) and Mueller (1979), there are analytical difficulties with these principles being used as a collective-choice rule to 'order' social states. But this is not what Rawls's aim is. Instead, he is concerned with finding out just institutions and distinguishing them from unjust ones. And in that context, Rawls seeks to *maximize the welfare of the worst-off individuals in the society.* When comparing two states of economy, a and b, the welfare of the worst-off individual is maximized, and, that done, the welfare of the next worst-off individual is maximized, and so on till the welfare of the (n-1) worst-off individual is maximized. Only then can the welfare of the *best-off* individuals be maximized.

This brief discussion shows that, while Pareto-optimality principle may be 'heartless', there are other decision-making rules which are born with a throbbing 'heart'. These alternative rules are, for that reason, more relevant for thinking systematically about the problems of economic development.

IS MORALITY A VIRTUE?

The public-choice perspective also helps to focus our attention on such basic issues as the limits of individual liberty and the place of moral and ethical perceptions in development philosophy. I now turn to a brief consideration of these matters.

(i) The Priority of Liberty

Buchanan's impassioned plea, based on normative judgement, for relying on the market is based on his "*faith* that an understanding of the price system offered the best possible avenue for the generation of support for free institutions;" and it is only through such an understanding that we can "preserve order based on individual liberty" (italics added). Thus, in Buchanan's view, individual liberty is accorded *priority* over all other social and economic imperatives – like ensuring

equality in income and wealth, providing basic amenities of life to the least privileged in the society, etc. (As noted above, a similar view is implicit in the Paretian Principle.) Buchanan deepens the normative colour of his argument by emphasizing that voluntary agreements reached through the markets are the *only* preservers of individual liberty, and that the involuntary agreements reached through government meddling are *always* spoilers of the fruit of paradise that individual liberty is.

This line of argument suffers from the fatal flaw that it *defines* specific market arrangements as voluntary or involuntary according as they are made, respectively, through the market or by the government. Then it derives from this definition the result that market arrangements are superior to those made by the government. But this is not a logical result at all. It is simply a restatement of the definition.

In John Rawls's view, which I recommend for the consideration of the development economist, central importance attaches to maximizing the welfare of the least-privileged classes of the society – viz. those who have less access to primary goods than others. And this view, according to Rawls, is *consistent with his attachment to the priority of liberty.* In addition to his two basic principles of justice noted above, Rawls makes the following important point: "Now the basis for the priority of liberty is roughly as follows: as the conditions of civilization improve, the marginal significance for our good of further economic and social advantages diminishes relative to the interest of liberty. . . ." In this perception, as Mueller (1979) points out, Rawls sees "liberty essentially as a luxury good in each individual's preference function." The implication of such an approach is that individual liberty is a 'consequence' of a restructuring of the basic institutions of the society in such a way that the needs of the least privileged are met first. In other words, individual liberty is *defined* as incorporating a system of rights in such a manner that it is preserved, indeed maximized, if as a result of the working of social and political institutions the entitlements to primary goods of the least privileged are met in all states of the economy.

(ii) The Importance of Moral Values

That part of literature on development economics which claims to be truly positivistic and 'value-free' is without doubt climbing the wrong tree. This is because even the so-called "objective" statements made on the strength of the Paretian philosophy, which is assumed to reflect the principle of unanimity, do involve a moral judgement. As Sen (1970) points out, "unanimous value judgements may provide the basis of a great deal of welfare economics, but this is not so because these are not value judgements, but because these judgements are acceptable to all." Thus there is no need, in the name of scientific rectitude, to rid development economics of ethical and moral norms and values. Indeed, scientific rectitude *requires*, according to Hume's Law, that a community must have concepts of

right or wrong in order to be able to make propositions about what ought to be done – to derive any prescriptive conclusions at all from empirical findings. It is this shared conceptualization of right and wrong that should guide the development economist in choosing morally acceptable collective-choice rules as a basis of social policy.

Equally reprehensible for the development economist should be the non-consequentialistic "entitlement principle of distribution" spelled out by Robert Nozick (1974) in his famous book, *Anarchy, State, and Utopia.* According to him, policies and actions should not be judged by their consequences. Government need not specify what a person should or should not have; for that would make it look too 'nosy'. It should, instead, restrict itself to specifying only the procedures that make actual individual holdings – say, private property – *legitimate.* But such a view cannot be acceptable. For if sticking to *procedures* alone makes you unmindful of the social consequences of a certain structure of property rights, even though they be legitimate, then these procedures, indeed the entire approach to the problem, must be revised. If, according to Nozick's principle, it does not matter how "happiness" comes about, what the sources of a given happiness are, and how that happiness is shared – whether grabbed by a few or distributed more widely – then, surely; "something is rotten in the State of Denmark."

"LET A THOUSAND FLOWERS BLOOM"

The public-choice perspective shows that the debates now rocking development economics – about freeing it from the clutches of a sterile government that invariably 'fails' to deliver; about making it more 'scientific' by letting it metamorphose into a neo-classical economics crab which obeys Pareto optimality like a Divine Law; about emptying development economics of any remnants of ethical and moral concerns – are really non-debates. These debates are not even 'scientific', because they fail to recognize the central importance of a widely accepted system of moral values for making scientific statements. These debates are also myopic because they stick to only one decision-making rule – viz. Pareto optimality – which is unrepentantly neutral with respect to various states of distribution.

The works of such distinguished economists as Wicksell (1967), Rawls (1971), Harsanyi (1977) and many others emphasize the need for a contractarian-cum-utilitarian framework to make the process of collective decision-making work. These approaches either presuppose (the utilitarian approach) or explicitly stipulate (the contractarian approach) the need for creating just institutions. These approaches have the merit of prescribing rules and issue directions for an optimal working of the government. The works of economists like Becker (1983) have further deepened our understanding of how the governments work to correct market failures even when

they are seen as competing for the political favours of the vested interest in the society.

The moral of the story is that there is more to development economics than a mere prescription for blind adherence to the rules of the market. With its normative props removed, the market arrangements look highly vulnerable and prone to 'failure' when it comes to a restructuring of the basic institutions of the society to ensure social justice. By the same token, Buchanan's claim of the innate failure of the government, on normative grounds alone, turns out to be without any normative or 'positive' foundation.

It is crucial for the continued vitality of development economics as a discipline to explicitly recognize that there is more than one collective-choice rule, which can be used as a basis for translating individual preferences into social preferences, and that such rules are deeply coloured by the ethical and moral norms widely shared by the society. It should also be understood that an intelligent evaluation of these rules is only possible through an understanding of their relativity with the nature of the society. There is no such thing as an ideal, or sure-fire, system of collective-choice rules that works equally well in all societies and for every possible configuration of individuals' preferences.

On this relativistic word of caution I end my quadrilogy on the state of development economics. Since March 1984, when the First Annual General Meeting of the Society of Development Economists was held, I somewhat presumptuously have taken upon myself the task of reaffirming our faith in development economics, and of clarifying basic issues, problems and debates about our discipline. Like Sheherzad, the mythical story-teller of the *Arabian Nights,* I have related the story of development economics to excite the imagination of some morose and indifferent Prince with neo-classical leanings to think with a clear head about people and problems. The aim of my story has been to understand the successes and failures of the market *and* the government in the wider context of social justice.

But social justice can only be achieved by creating institutions which can transmute the longing for a better world into a set of policies that aim at changing the present sickening *status quo* in the developing countries. It should be clearly understood in this connection that the fact that an outcome – say, a particular outcome of the workings of the market – comes to be widely accepted and is not openly questioned does *not* make it necessarily a desirable outcome. In a world marked with extreme poverty, a tacit acceptance of *status quo* is not a sign of its endorsement. "The underdog learns to bear the burden so well that he or she overlooks the burden itself. Discontent is replaced by acceptance, hopeless rebellion by conformist quiet, and . . . suffering and anger by cheerful endurance" (1984).

But acceptance, conformist quiet and sullen endurance of sufferings cannot be used by policy-makers in the developing countries as excuses for policy inaction to

let the *status quo* be perpetuated. We cannot afford to be ideologically neutral Neros with a truant disposition, carousing light-heartedly though diligently, but caring little for the consequences of our actions. And when these consequences involve the welfare of the large, though silent, majorities in the developing countries, the development economist cannot afford to "speak like a green girl, unsifted in such perilous circumstances." If we claim to be scientists, armed with knowledge and committed to a social purpose, then we must know what scientific rectitude entails. And if we propagate the great virtues of individual freedom that market arrangements allegedly signify, then we must honestly reflect on whether it is freedom for only a privileged few or freedom for all. The litmus test that all theories and institutions must pass should establish their contribution to, and relevance for, ensuring of social justice. I fully endorse John Rawls's homily to social philosophers: "A theory however elegant and economical must be rejected or revised if it is untrue; likewise laws and institutions no matter how efficient must be reformed or abolished if they are unjust." Let this be the watchword for the development economist as well.

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Comments on "The Anatomy of 'Failures'"

Professor Syed Nawab Haider Naqvi has delivered a penetrating address on "The State of Development Economics". He has aptly charted the undercurrents which will determine the surface image of our field in the years to come. This year he pushes beyond the monetarists and the rational expectationists ("ratex") that he covered last year in his address, and he examines the claim that "public choice theory offers an intellectually sophisticated government failure analogue to the earlier market failure thrust of welfare economics".

The main theme is the role of markets in economic development. One can put this theme in terms of the Genesis Story. As told by Adam Smith, "In the Beginning there were Markets". The Genesis Story according to Buchanan's catallactics goes further: "In the Beginning there were Perfect Markets: a world of atomistic buyers and sellers where *economic power* becomes meaningless." For development economics, on the other hand, markets are not the beginning, but the end: "In the End there will be Markets." This is a crucial difference and it should guide us in what is today popularly known as "The Great March to Free Market Systems". This march demonstrates, if anything, that complex industrial societies cannot be run by central planners; they have to be run by a looser mechanism that has feedback loops. Nevertheless, recent history, in the "Southern Cone" in specific, also demonstrates that "the great march to free market systems" if started prematurely it becomes a stampede right into the quicksand of financial blow-ups and insolvency.

So, development economics is properly in the rear-guard (and on its guard) of the "great march to free markets". The reason goes beyond Kenneth Arrow's dilemma: the informational economy achieved by the market system is not realized when no markets exist to supply this information in the form of prices — also known as market failure. Beyond market failure, markets in LDCs are not atomistic; they are cartelized; they involve players who wield widely asymmetrical market power; they are fragmented.

Professor Naqvi's search for alternative choice rules applicable to LDCs reaches to normative issues of morality in an individual's behaviour and to positivist issues of creating the right kind of institutions. Harsanyi's personal preference plus moral preference approach is also echoed, it seems to me in issues that the "new institutional economics" has raised: bounded rationality, moral hazard, adverse selection of risk, asymmetric information, among others. They all should find their place in development economics.

Correspondingly, the Rawlsian concept of sequential institution-building in the orderly progress of civilization should also find its place in development economics. Rawls states that as civilization improves the marginal significance for our own good of further economic and social advantage diminishes relative to the interest of liberty, i.e., liberty is essentially a luxury good in each individual's preference function. Correspondingly, we can hypothesize that economic freedom and free markets are a luxury good, having a high income elasticity of demand once a certain point is passed — once the society becomes a complex industrial society. Until then, the curtailment of unfettered market competition may be necessary so that the needs of the least privileged are met first. This tentative hypothesis will certainly need further elaboration and testing but the current stirrings in the USSR, in China and in Korea lend it some probative support.

Professor Naqvi's address raises important issues that drive to the heart of our field of development economics.

Stanford University,
U.S.A.

Pan A. Yotopoulos