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THE FUTURE OF PRIVATE ENTERPRISE IN THE DEVELOPING COUNTRIES

by

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A number of developments over the past year have raised questions about the kind of economic organization that is most beneficial to the developing countries of the world. After a brief period of quiescence in the debate between the advocates of the free market and those who wanted a high degree of state planning and control, trends in thought that are reminiscent of those encountered over a decade ago have begun to reappear.

In the late 1950's and early 1960's there had been a strong tendency to look to governmental enterprise and direction as a means of promoting the kind of rapid economic growth desired by the developing countries. This was reflected in the strong emphasis on central economic planning in the early years of the Alliance for Progress. It was also reflected in the enthusiasm expressed in some quarters for various degrees of socialist experimentation, ranging from very mild cases to the communization of Cuba by Fidel Castro.

Toward the end of the 1950's there were strong fears expressed about the possibility that the Soviet Union would overtake the United States economically. The late Nikita Khrushchev confidently boasted that by 1970 the USSR would outstrip the United States in per capita production. Among the less developed countries, India, with its emphasis

on central planning and heavy industrial development, was widely regarded as the Free World's entry in the economic race against Communist China. It was said that the battle for the minds of men in the developing countries might well hinge on how well India did economically in comparison with Mainland China.

In Latin America, there was a certain fascination with the ambitious goals proclaimed by Fidel Castro. By stripping away private property and the free market system, he was going to remake Cuba, converting it into a diversified industrial economy.

All of this involved a rejection of the economic philosophy that had held sway for nearly two centuries. This was the theory that the best way for countries to increase their wealth was by giving private individuals both the incentive and the freedom to plan and carry out economic enterprises. The free market economists had argued that governmental regulation and control, not to speak of state enterprise, tended to stifle imagination, drive and efficiency. They had maintained that the market process not only did a better job of stimulating increased productivity, the key to increased wealth, but it also did a better job of allocating resources to production that would satisfy the wants of the people.

The economic adversities of the 1930's had produced a considerable amount of disillusionment with this theory. The failure of the free market system to maintain a high degree of employment of resources over a prolonged period of time in the United States and Europe, led many people to the conviction that state enterprise or central planning that could override market forces would provide a more rational economic program.

This was particularly appealing to many of the men who rose to positions of leadership in newly independent countries in Asia and Africa in the period following World War II. Their criticism of the old order was in many cases based not only on the case for political independence but also on the grounds that it was based on an obsolete economic philosophy.

Disillusionment with Central Planning

The 1960's was a decade of testing of the new approach to economic development. It proved also to be a decade of disillusionment. It had become apparent long before the decade drew to a close that many of the high hopes that central planning and state enterprise would provide a key to more rapid and more healthy economic growth were doomed to disappointment.^{1/}

The first signs of trouble had already manifested themselves in the late 1950's in Eastern Europe. The Hungarian revolt of 1956 had economic as well as political causes. There was profound discontent with the way the economic system was functioning even among high officials of the Communist regime. The following year, Milovan Djilas, the disillusioned former vice president of Yugoslavia published his book, The New Class, which included this searing indictment of the economic system prevailing in Eastern Europe:

Planning takes very little account of the needs of world markets or the production of other countries. Partly as a result of this...governments take too little account of natural

^{1/} Irvine, Reed J., "Some Lessons of the Development Decade," Asian Survey, July 1970, pp. 552-61.

conditions affecting production. They often construct industrial plants without having sufficient raw materials available for them and almost never pay attention to the world level of prices and production. They produce some products at several times the production cost in other countries. At the same time industries of above average potential productivity are neglected. Entire new industries are being developed even though world markets are surfeited with the items they will produce.^{2/}

Mainland China

These early warning signs from Eastern Europe were obscured in most of the developing countries. Far more attention was given to China's so-called Great Leap Forward of 1958. Extravagant claims of greatly increased food production came out of China. A former director of the UN Food and Agriculture Organization exulted that Communist China had banished hunger for all time. A long article in the American Economic Review proclaimed that China was decisively beating India in the economic race, even when the claims of Chinese production were discounted for possible error.^{3/} But within two or three years hunger was again stalking the countryside in Communist China. Massive grain imports had to be obtained from the outside world. The blame was officially placed on bad harvests due to bad weather, but it was clear that the claims of food production in 1958 had been vastly inflated. What had been labeled the

^{2/} Djilas, Milovan, The New Class, Praeger, New York, 1957, p.121.

^{3/} Malenbaum, Wilfred, "India and China: Contrast in Development Performance," American Economic Review, June 1959, pp. 284-309.

"Great Leap Forward" was converted in a period of great hardship and depression that could appropriately be called the "Great Leap Backward."^{4/} The agricultural failures, brought on by the communist reorganization of agriculture, were accompanied by serious setbacks in other fields as well. Factories could not be supplied with raw materials, both because of imbalances that had developed and because of transportation tie-ups. It was admitted that there had been excessive and uneconomic investments at a pace that could not be sustained. A prolonged depression ensued, during which the publication of economic statistics was halted.

U.S.S.R.

On the heels of the failures in China, there came reports of serious economic problems in the original home of the statist economy-- the Soviet Union. Soviet engineers and later economists began to point out that the system of planning all economic activity from the center produced some highly inefficient uses of resources. The emphasis upon fulfilling quantity targets resulted in little attention being paid to the quality of the workmanship and often to the costs of meeting goals set at center. As a result the quality of much of the output of Soviet industry was extremely poor. In the capital goods area, equipment did not work properly or broke down with maddening frequency. As a result, an excessively high percentage of the capital equipment was out of order or under repair. The same problems existed with respect to consumer goods.

^{4/} Irvine, Reed J., "The Great Leap Backward," The Nation, August 11, 1962, pp. 46-49.

Everything from small electric appliances to automobiles tended to break down too quickly and too frequently. Not only were consumers dissatisfied with the quality of the goods, but the planning system failed to furnish them with the kind of goods they wanted. For example, since furniture targets were expressed in terms of weight, it was easier to achieve the targets by producing massive, heavy furniture than by producing attractive, light weight furniture of the Scandinavian variety. Style and quality meant nothing to the producers even though it might mean a lot to the consumers. As the internal critics of the system pointed out, there was no adequate provision for consumer feedback to influence the producers. They were responsible to the central planners, not to the consumers.

These criticisms became sufficiently numerous and persuasive that the Soviet regime decided to experiment cautiously with modifications that would decentralize some of the decision-making powers in industry and try to give greater attention to user demands. These decisions themselves, however, focused greater attention on the shortcomings of the system of highly centralized economic planning.^{5/}

India

Hard on the heels of the growing realization that all was not well with the system of central planning and state enterprise in the Soviet Union itself came a serious economic setback in India, a country widely regarded as the leading protagonist of state direction of economic

^{5/} Reforms in the Soviet and Eastern European Economies, edited by L. A. D. Dellin and Herman Gross, Heath & Co., 1972, pp.6-7, 24-36.

activity in the non-communist world. India's ambitious third five-year plan, which had placed heavy emphasis on the development of heavy industry and which slighted the agricultural sector, ran into difficulties and could not be executed as planned. Food shortages developed, partly because of bad weather but partly because of the neglect of the agricultural sector, which provided the livelihood of three-quarters of the population. Food had to be imported in large quantities to avert famine, and at the same time, the industries that had been created at heavy cost were contributing very little to the export earnings of the country. On the other hand, imports of fuel and raw materials were required to keep industry operating and India found herself unable to foot the heavy import bills that would have been required to keep her new industries going at full capacity.^{6/}

All of this stimulated a great deal of rethinking about the high hopes that had been built up about Indian economic planning as a model for the economic development of the rest of the world, Africa and Latin America. It was widely agreed that the sacrifice of agricultural development to create heavy industry in a hurry had been an error. It was also agreed that it had been a mistake to develop industry with a view to replacing imports but without much thought being given to development of export capabilities. Finally, serious concern developed over the discovery that the rate of return on investments in the public sector was

^{6/} Government of India "A Supplement to the Economic Survey," July, 1966, pp. 3-5.

very low, far lower than the rate of return on comparable investments in the private sector. This was taken to be an indication of both poor allocation of resources and inefficiency in the management of those resources in the public sector.^{7/}

Czechoslovakia

Still another blow to the proponents of centralized government planning and direction of the economy came from Central Europe. Czechoslovakia had been the most highly industrialized of the Soviet satellites. It provided the best ground for testing orthodox Marxism. Marx had held that it would be capitalism that would provide the drive that would bring about industrialization and that socialism would then take over and humanize the economic system. In Czechoslovakia the communists took over an already highly developed industrial system. They had a chance to humanize it and create a more just social order.

After 20 years, the dissatisfaction within Czechoslovakia, both political and economic, was so great that the Communist Party was compelled to publicly confess its failures and promise drastic reforms. New leadership took over the party, with the promise that they would, after two decades, try to give the system a "human face." In April 1968, they published their "Action Program," which included some very frank analysis of what had gone wrong. In view of the length of the Czechoslovakian experiment, the favorable circumstances under which it began

^{7/} A. D. Shroff, On Planning and Finance in India, Lalvani, Bombay, 1966, pp. 263-268.

and the determined effort made to achieve success, the reasons for the failure ought to be widely studied. This is what the leaders of Czechoslovakia themselves said in April 1968, rendered in a free translation to avoid some of the more turgid jargon:

The measures adopted did not bring the anticipated results. On the contrary, over the years, difficulties piled up until they closed in a vicious circle. Ideas that were not valid dominated policymaking, such as the notion that construction of the new society depended only on the accelerated development of production. This led to an excessively rapid expansion of heavy industry, which required excessive amounts of labor, raw material and costly investment.

Such an economic policy, enforced through government decrees, no longer corresponded to the economic requirements and possibilities of the country and led to exhaustion of its material and human resources. Unrealistic tasks were imposed upon the economy and false promises were made to the workers. This intensified the unfavorable structure of production and resulted in the misuse of our skilled labor. The result was considerable technical retardation in Czech production. It put a brake on development of public services, upset the equilibrium of the market, worsened the international position of the Czechoslovak economy, especially in the field of trade, and finally had to end in stagnation and in certain cases even in the reduction of the living standard of the people.

These shortcomings were directly caused by the old directive system of management: Directives from the center replaced economic criteria, the law of supply and demand and marketing ties. Socialist enterprise did not expand. In economic life, independence, diligence, expertise and individual initiative were not appreciated. On the contrary, what was appreciated was subservience, obedience and even kowtowing to higher-ups.^{8/}

^{8/} E110, Paul, Czechoslovakia's Blueprint for Freedom, Acropolis Books, Washington, pp. 97-98.

One of the conclusions of the Czech leaders was that even though the Communist Party had long criticized egalitarianism, in practice there had been an unprecedented reduction in inequality in Czechoslovakia during these two decades. They observed that this had been one of the impediments to the development of the economy and raising the standard of living. The Action Program said:

The harmfulness of egalitarianism lies in the fact that it gives careless workers, idlers and irresponsible people an advantage as compared with the dedicated and diligent workers, the unqualified compared with the qualified, the technically and expertly backward people as compared with the talented and those with initiative.^{9/}

The Czechoslovak leaders therefore concluded that in the future the remuneration for work should depend on the productivity of the workers and that appropriate rewards should be given for initiative, the degree of responsibility and the risk taken. They said:

This is in the interest of the development of the whole society. The principle of actual achievements raises the technical standard, profitability and productivity of labor, respect and authority of the managers responsible, the principle of material incentive. It stresses the growing importance of qualifications of all workers.^{10/}

They went on to pay tribute to the importance of good management, saying:

One of the key conditions of the present and future scientific, technical and social development is to substantially increase the qualifications of managers and experts at all levels of economic and social life. If the leading posts are not filled by capable, educated socialist expert cadres, socialism will be unable to hold its own in competition with capitalism.^{11/}

^{9/} Op. cit., p.108
^{10/} Ibid.
^{11/} Ibid.

The sad fact that emerges from this document is that the Czechoslovak experiment did not succeed in producing a more human economic system. It did the reverse. Because the system was inefficient and retarded technical progress, it impeded the lifting of living standards and in some cases reduced them. Riddled with illogicalities and unable to satisfy human needs the system could be maintained only by brutal and thoroughgoing repression. Dr. Ota Sik, the leading proponent of economic reforms in Czechoslovakia in the 1960's and a deputy prime minister in the Dubcek government in 1968 has made this point in a recent article, saying,

(The) nationalization and bureaucratization in Communist countries has led to an unheard of wastage of capital and production resources and to such ineffective development of investment and production that the system can be maintained only by authoritarian and totalitarian regimes.^{12/}

Cuba

On top of these various economic lessons from bitter experience in Europe and Asia, there came Fidel Castro's admission of economic failure in Cuba. In his address of July 24, 1970, Castro admitted that Cuba was suffering from the same kinds of problems that had plagued Czechoslovakia. He attributed Cuba's economic difficulties to the "ignorance" of Government leaders, to low labor productivity, absenteeism, disorganization and shortages of capital goods. "Let me say this," Castro declared, "neither this nation's economy nor that of any other nation can tolerate the corrosive, demoralizing and disruptive actions of 400,000 shirkers." The figure of 400,000 represents 20 per cent of Cuba's labor force. Castro has also said: "Productivity has been practically forgotten and the lack of it is a bottomless pit that can swallow all of the country's

^{12/} Sik, Ota "The Maudling Memorandum: A Communist Critique," The Times, (London) Oct. 4, 1972.

human resources." Spelled out in terms of its practical consequences for the Cuban people, this means material shortages and continuing stagnation or retrogression of living standards. As one commentator said after Cuba's failure to harvest the target of 10 million tons of sugar in 1970: "They were promised that success in the harvest would end their troubles. Now they know their troubles are probably endless."

All of these experiments ran into difficulties because of a failure to take a realistic view of human nature. The plans were built on a conception of man as the rulers thought he ought to be, not as he actually was. Thus, as René Dumont, the French agricultural expert who frequently advised Fidel Castro pointed out in his book, Cuba: Is it Socialist?, absenteeism was very high in Cuba because the workers could earn enough to buy all of their rations in the first third of the month. Most of them saw no point in working just to accumulate money that could not be exchanged for anything they wanted. The dreamers had thought they could inspire man to work for higher, altruistic motives, but this proved to be far more difficult than they imagined. Castro acknowledged this in a 1968 speech, saying:

If one thinks that man is incorrigible, and that it is not possible for him to progress except by egoism. that mankind is incapable of developing a conscience, then the doctors of economics are right, the revolution courts catastrophe...The struggle to create a superior form of social life is one of the most difficult there is, one of the routes most difficult for a people to take.^{13/}

^{13/} Dumont, René, Cuba: Est il Socialiste?, Edition du Seuil, Paris, 1970, p. 57.

Conclusion

While these countries were learning by bitter experience that the "doctors of economics" were right, other countries that had assumed this from the beginning were reaping a rich harvest of material progress that redounded to the benefit of their working classes. Thus the countries that recorded the most impressive economic progress and the greatest advances in living standards in the past decade were not centrally planned economies, but countries like Japan, Taiwan, Korea and Mexico. These were countries that recognized from the beginning that initiative, diligence, responsibility and risk should be rewarded. These were countries that did not try to remake human nature, but that permitted human nature to function in ways that brought great benefits to the entire society.

If broad political movements were influenced by careful analysis of the lessons of past experience, there would seem little reason today to reopen the question of the form of economic organization that the developing countries should adopt in order to achieve sound and sustainable economic growth. The developing countries certainly do not need to waste ten to twenty years experimenting with visionary schemes that might succeed only if all men were angels. Indeed, they cannot afford the cost of such experiments. It would be far better if they would study with care the bitter lessons that have already become clear from the experience of the Eastern European countries, Communist China, India and Cuba.

Nevertheless, the issue has been reopened. Chile, by the electoral process, has brought to power a government dedicated to increasing the governmental direction of the economy to a high degree. Influential groups

elsewhere in Latin America are striving to move other countries in the same direction. An observer of trends in Latin America has recently written of "the new clergy and the new military" moving "toward that inevitable alliance that will create that new social and economic structure existing thus far only in the minds of a handful of Latin American visionaries." He states that its politics may displease North American liberals as its economics must displease North American conservatives. It is probable that this movement will acquire added impetus from the added prestige and influence that will accrue to Communist China as a result of its admission to the United Nations and the great increase in its diplomatic recognition by more of the developing countries.

Despite all the lessons of the past two decades there is no shortage of those who are willing to spread the illusion that some remarkable transformation of man's economic state can be effected simply by eliminating the free market, the private sector and turning control of the economy over to government. The popularity of this notion is probably inversely correlated with knowledge of what goes on in the real world of economics. It may also be inversely correlated with understanding of human nature. If so, the reopening of this issue, which should have been laid to rest long ago, can be traced to a failure to convey knowledge of the economic fiascos that these ideas have already produced.